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A PROJECT OF EMPIRE

A CRITICAL STUDY OF THE ECONOMICS OF IMPERIALISM, WITH SPECIAL REFERENCE TO THE IDEAS OF ADAM SMITH

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The rulers of Great Britain have, for more than a century past, amused the people with the imagination that they possessed a great empire on the west side of the Atlantic. This empire, however, has hitherto existed in imagination only. It has hitherto been, not an empire, but the project of an empire; not a gold mine, but the project of a gold mine.—ADAM SMITH.

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PREFACE

THE question of imperial defence has suddenly become of pressing importance, and has directed public attention to other aspects of imperial union. The object of the present book is to reconsider the economic problems involved in their due order and proportions.

And first of defence: So long as this country could maintain the undisputed command of the sea we could afford to wait in case of need for the aid of the overseas dominions. But recent events have shown that this country ought no longer to attempt to provide from its own resources for the naval defence of the whole empire; and in a great naval war there would be no time to call up the ultimate or potential reserves of men and money from the ends of the earth.

The self-governing colonies have grown into self-conscious nations, and the recent conference has shown that they recognise that the primary duty of every nation is to provide for its own defence against foreign attack.

This duty, however, may be performed in two different ways or according to two different ideals; which may be termed the national and the imperial. On the first plan each dominion or commonwealth, or state or nation, would look mainly to its own defence and to the trade routes in which it is most interested. The ultimate ideal would be effective national independence; and imperial defence would be resolved into a friendly alliance between the different nations.

On the second plan each constituent state would contribute to the defence of the whole empire according to some definite scheme; as, for example, by the assignment of certain revenues for imperial purposes, or by a payment in proportion to population, or by some combination of these methods, as in the case of the German empire, where imperial revenues are supplemented by the matricular contributions of the states.

On the first plan, if we look to the natural growth of the British empire, in the course of a century—a short period in the history of nations—there would probably be five *de facto* independent nations, connected only by nominal ties of sovereignty, and relying on conferences for the exchange of ideas and the acceptance of informal agreements. In such a scheme India, the Crown colonies, the protectorates, and other "appendages" would be considered as special "possessions" of the United Kingdom which would alone bear, as at present, the supplementary

costs of defence and administration. In the course of time some of these possessions might become *de facto* independent, or be transferred to an adjacent "colony."

On the second plan there would be a union as real as that of the constituent parts of the United States or the German empire. In this scheme the "appendages" would be *de facto* possessions, not of the United Kingdom but of the British empire.

It is obvious that a real imperial union of this kind would involve the institution of some form of federal government, in which the constituent states were represented. It is beyond the range of the present inquiry to consider the political difficulties involved. It is clear, however, that a real federal government of this kind, although established in the first place for defence, would naturally be used for the furtherance of other objects. Of these secondary objects of political union the most closely connected with defence is the growth of wealth, population, and organisation. And for this economic development a common defensive policy would naturally be supplemented by a common policy, both as regards trade within the empire, and also as regards commercial relations with foreign states; and in both cases the ruling idea would be the economic development of the empire as a whole.

For this further development free trade within the empire seems to be one of the fundamental require-

ments; especially if the appeal is made to recent experience in empire-making. Internal free trade (*i.e.* between the constituent parts of the empire) is consistent either with external protection of the most extreme kind or with the complete absence of differential duties or with any *via media*. In the United Kingdom, for example, free trade between England, Scotland, and Ireland was established whilst the home market was protected against the foreigner by "high duties and absolute prohibitions"; and no one doubts that for the United Kingdom as a whole, this internal free trade has been most advantageous.

On this point the history of the United States of America is also most instructive. The thirteen states united to gain their independence; and for six years after the independence was gained they celebrated their freedom by insisting each for itself on its own sovereign power in making commercial treaties and imposing customs duties — sometimes against one another. The Constitution of 1789 vested this power in the federal government; the thirteen commercial "nations" became one commercial "nation"; and with the accession of new states this internal free trade has been extended over vast territories.[1]

Internal free trade within the empire would be accompanied naturally, though not necessarily, by the acceptance of common principles and common action in foreign commercial relations. From the

[1] See below, Chapter XVI.

point of view of the power of the empire as a whole, such common action would have great advantages, *e.g.*, in making commercial treaties or, in case of need, in retaliation.

The simplest solution would be a uniform customs system, but uniformity is not essential either to free trade within the empire or to a common commercial policy. The ideal of internal free trade would be attained if the colonies were to carry their preferences to the extreme of reducing the duties on the products of the rest of the empire to zero; although the United Kingdom retained its free trade system, and the colonies in each case its own protective system against the rest of the world.

To insist that internal free trade (*i.e.* within the empire) can only be established if, as a necessary *preliminary*, this country adopts protection, or the colonies adopt external free trade, is to put needless and probably insuperable difficulties in the way. At the same time, the advantages of a real commercial union of all parts of the empire, based on internal free trade and external common policy, are so great that the question ought to be considered from the point of view, not only of the constituent parts, but of the whole. Free trade and protection are only means to the achievement of national and imperial aims.

Such are the fundamental questions involved in the economics of empire: defence, internal commercial relations, and external commercial policy.

In dealing with these questions, I have taken as the basis the treatment by Adam Smith; for several reasons. The *Wealth of Nations* was written under the influence of the events which led up to the separation of the American colonies and the acquisition of India. Then, as now, problems of empire were of urgent importance; then, as now, trade and trade policy were intertwined with questions of defence and sovereignty; then, as now, we were faced with the alternatives of real union or disintegration; then, as now, we had not an empire, but the project of an empire. It is admitted on all sides that Adam Smith was the greatest of economists, but the stress laid on certain parts of his work has caused others to be neglected; and in this over-emphasis and neglect the sense of just proportion has been lost. No other writer has approached him in the breadth of view and in the appreciation of the different elements involved in the economics of imperialism.

The popular idea that Adam Smith was cosmopolitan in his moral and political sympathies is exactly the reverse of the truth. He was intensely nationalist; and his nationalism was founded upon general principles that are specially vindicated in the last edition of his *Theory of Moral Sentiments*.[1] His nationalism grew with the expansion of the nation until, as the logical conclusion of his great work, we have the most thorough scheme of British imperial

[1] See below, Chapter II.

union ever propounded. Both politically and economically this imperialism was founded on ideas that have their roots far back in English history. Politically Adam Smith looked to the development of the British constitution; with representatives from every part of the empire, and with the monarchical and democratic elements growing in due proportion. Economically his ideal was that the empire should furnish one immense internal market for the produce of every part of it; and that for imperial needs certain taxes (of which taxes on land and customs duties are of special interest) should be levied throughout the empire on a uniform system.

The climax of the argument of the *Wealth of Nations* is an appeal to British statesmen, and to the British people both in the mother country and in the colonies to convert the project of empire into the reality.

Equally erroneous are popular ideas on Adam Smith's treatment of free trade and protection. Here also his point of view is national and imperial and not cosmopolitan. He emphasises more than any subsequent writer the importance of the home market, and the advantage of the employment of the capital of the country within the country; so strong indeed is his view on the encouragement of home labour and home industries that he has been claimed by protectionist writers as the founder of protection. And yet, as all the world knows, it was to Adam

Smith more than to any statesman that the adoption of free trade by Britain was due; he it was who gave the ideas with which other people worked. Unfortunately, in simplifying these ideas for popular consumption the setting was cast aside, and with the setting many of the ideas also. Free trade was converted into a kind of religious dogma far removed from the principles of the original author.

Of the lost ideas of Adam Smith two may be here cited. One is the importance of the local habitation of the capital during the process of consumption and reproduction. The popular idea that the employment of capital that is most profitable to the individual (whatever the mode or place) is of necessity also the most advantageous to the nation is utterly opposed to the central doctrine of Adam Smith. From his standpoint it is only the surplus of a nation's capital that can be exported with advantage to the nation. The home requirements should be first met before capital is sent abroad. Capital may be sent abroad for temporary employment in foreign trade or for permanent investment,—even the interest being reinvested,—and between these two extremes there are endless degrees in the absenteeism of capital. Of these differences in the national advantage of employing capital in different modes Adam Smith takes account in a chapter which might well be called the forgotten chapter of the *Wealth of Nations*.[1]

[1] Bk. II. chap. v. See below, Chapter VI.

The other lost idea of special interest at present is as regards the mobility of capital. In what is called the pure theory of foreign trade it is assumed that between different "economic nations" there is no mobility of capital or that the mobility is so imperfect that for theory it may be neglected. Adam Smith, on the other hand, held the view confirmed by experience (and it may be said in harmony with the "modern" principle of continuity) that foreign trade can only be carried on by sending a certain amount of capital out of the country.

These lost ideas have again been forced on the public attention by two significant facts: first, the enormous investments of British capital in foreign states; and secondly, the increasing tendency in recent years in the commercial policy of other nations towards the protection of native industries.

The dogmatic simplification of free trade has had the result that many people think they have made out a case for protection when they have partially re-discovered the ideas which Adam Smith elaborated, to the verge of paradox, on the advantage to a country of the employment of its own labour by its own capital. Always bearing in mind the supreme importance of the home employment of capital, Adam Smith tried to show that "high duties and absolute prohibitions" were either useless or hurtful. But he did not rely on abstractions and hypotheses; he might have said with his revered Newton *hypo-*

theses non fingo; so constantly did he appeal to facts and experience. At this time of day also, the protectionist and free trader, unless they wish to engage in a barren exchange of truisms, must be content to follow his example. And, perhaps, at the present juncture the reference of the case to a strong Royal Commission would be the most effective way of making the appeal to experience.

In taking as the basis of the present survey the ideas of Adam Smith, there is no intention of any appeal to authority; to search his scripture for texts which shall solve modern problems would be to miss entirely the spirit of his method. Accordingly, throughout, an endeavour has been made not only to illustrate by modern instances, but to express his ideas in modern equivalents.

In spite of the changes in the means and conditions of war, the military writer still appeals to the ideas and methods of the great soldiers and admirals of the past; and in this sense and in this sense only, an appeal is made to the authority of the greatest of all economists.

Incidentally, however, it seemed desirable to show the way in which Adam Smith himself applied his ideas to the similar problems of his own day, and although that was not the primary intention the present work may be considered on one side as a critical study of the *Wealth of Nations*; whilst on the other it deals with present problems.

In the final chapter I have given my own opinions on the ultimate aims of imperial union and on the methods by which the ideal may be approached. These opinions are in some respects different from those expressed in the chapter on Colonies and Dependencies in my *Principles of Political Economy*.[1] The difference is in the main one of emphasis, and the change in emphasis is due to the change in conditions. Now that imperial organisation for defence has become a necessity, imperial union for other purposes may be an advantage.

J. S. N.

University of Edinburgh,
December 1909.

Note.—The references in the notes without special title are to the *Wealth of Nations*.

[1] Vol. iii. Bk. v. chap. xix., first published in 1901. In an introductory essay prefixed to an edition of the *Wealth of Nations* published in 1884 (Nelson), I called attention to the importance of Adam Smith's ideas on the employment of labour and on imperialism. See also my Essay on Tariffs and International Commerce in the volume on *Britannic Confederation* (1892).

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CHAPTER I

THE PERSONALITY AND BREADTH OF VIEW OF ADAM SMITH

§ 1. *Personality and Character.*

By way of preliminary it is necessary to get rid of some popular prejudices about the character and personality of Adam Smith.

Those who think he was a kind of parrot who could only say "cheap food," "competition," "let alone," "devil take the hindmost," and other simple cries, will be surprised to hear that, with the possible exception of Lord Bacon, he was the most broad-minded and most sympathetic of all the philosophers who have condescended to make themselves intelligible to the common man. He had planned "a connected history of the liberal sciences and elegant arts." For this purpose he had collected a mass of material and written a variety of papers, some of which, published by his executors, illustrate in a curious manner his breadth of view. There is, for example, a fragment on the affinity between music, dancing, and poetry. This is of special interest at the present time with the revival of the methods

of the classical "pantomime" dances. Adam Smith shows, by "philosophic art," that dancing (of the descriptive kind) is capable of affecting us much more than statuary or painting, and that like epic poetry it can represent all the events of a long story. In another paper he made a comparison of English and Italian metres to the admiration of Dr. Johnson, who said he could have hugged him for his preference of rhyme to blank verse. There is an essay on the formation of languages and a history of astronomy. His appreciation of Newton's great discovery shows that it was not for want of mathematics that he did not set much store by political arithmetic.

The influence of Newton is shown by the analogies adopted to illustrate two of the fundamental principles of the *Wealth of Nations*. First, the theory of natural and market values: "The natural price, therefore, is as it were the central price to which the [market] prices of all commodities are continually gravitating. . . . But whatever may be the obstacles which hinder them from settling in this centre of repose and continuance, they are constantly tending towards it."[1]

Secondly, the theory that "naturally every individual endeavours to employ his capital as near home as he can"—a principle that is constantly appealed to—is expressed in similar terms: "Home is in this manner the centre, if I may say so, round which the capitals of the inhabitants of every country are continually circulating and towards which they are

[1] Book I. chap. ii.

tending, though by particular causes they may sometimes be driven off and repelled from it toward more distant employments."[1]

The catalogue[2] of Adam Smith's library illustrates the variety of his tastes and learning. He was widely read in history, law, geography, and books of travel. He knew all the best men of his time—Pitt, Burke, Hume, Reynolds,[3] for example, in England; and in France, Turgot, Voltaire, Quesnay, Rousseau, and the philosophers who were sowing the seeds of the revolution in France.

For the greater part of his life Adam Smith lived in touch with the great world and the real world, and not in a world of abstractions, though for the final composition of the *Wealth of Nations* he retired to the quiet of his native town, Kirkcaldy, for a period of seven years (1767-1773).

§ 2. "*The Theory of Moral Sentiments.*"

The Adam Smith of popular tradition is supposed to be the apostle of selfishness—the creator and glorifier of the "economic man."

The real Adam Smith, about twenty years before the publication of the *Wealth of Nations*, made a world-wide reputation by his Essay on the *Theory of Moral Sentiments*. The basis of the whole theory is not selfishness but sympathy; the practical test of right conduct is the judgment of the impartial

[1] Book IV. chap. ii. [2] Edited by Dr. Bonar, 1894.

[3] The writer is the fortunate possessor of Adam Smith's presentation copy of the *Wealth of Nations* to Sir Joshua Reynolds.

spectator. "When the happiness or misery of others depends in any respect on our conduct we dare not, as self-love would suggest to us, prefer the interest of one to that of many." And yet it is "not the soft power of humanity, it is not that feeble spark of benevolence which nature has lighted up in the human heart, that is thus capable of counteracting the strongest impulses of self-love. It is a stronger power, a more forcible motive which exerts itself on such occasions. It is reason, principle, conscience, the inhabitant of the breast, the man within, the great judge and arbiter of our conduct."[1]

The man within is the ideal of humanity; he is the true impartial spectator to whom the final appeal must be made. To this work on moral philosophy Adam Smith made some important additions just before his death in 1790. One passage is strangely pathetic: "It is only to the virtuous and humane that the infirmities of old age are not the objects of contempt and aversion. In ordinary cases, an old man dies without being much regretted by anybody. Scarce a child can die without rending asunder the heart of somebody." It was found on his death that his property was much less than had been expected, because he had given away the greater part in secret charity.

It may perhaps be thought a matter of little

[1] The need for emphasising the moral philosophy of Adam Smith is shown by the following quotation from the Introduction to Byles's *Sophisms of Free Trade* signed by the editors W. S. Lilly and C. S. Devas: "No doubt Adam Smith regarded his political economy as a branch of his moral philosophy. But unfortunately his moral philosophy is in no true sense moral."—*Op. cit.* Introduction, p. xviii, note.

importance in applying the ideas of Adam Smith to our present economic problems to show that he was not a "one-eyed flatfish with the side on which there is an eye always in the mud," but a man as keen in his appreciation of art and literature as his principal detractor—and with a far wider outlook and larger sympathies.

§ 3. *Humanist and Nationalist.*

Adam Smith had, no doubt, an exceptional genius for dealing with the economic side of human affairs, and he is rightly regarded as the founder of systematic political economy as distinct from the allied moral and social sciences; but his influence as an economist was enormously increased owing to his breadth of view, both moral and intellectual. Adam Smith was emphatically a great humanist, and that is the reason why, in treating of new economic problems, it is well to refresh our sympathies and sharpen our wits by a study of the master mind in this part of life. In particular we may learn of Adam Smith that questions of foreign trade require for their adequate discussion a reference to the great ideas of humanity and nationality as well as the more material interests of cheapness and plenty.

In the whole range of the history of perversions there is no more curious error than the popular idea that Adam Smith treated of the wealth of nations from the cosmopolitan standpoint, and that List, as opposed to Adam Smith, is the founder of national economy. If the two men are to be named by these

two names, then it is Adam Smith who must be ranked as the nationalist and List as the cosmopolitan. List[1] had apparently taken his views of Adam Smith not from the original source but from the "school," and indeed it is to the "school" that he constantly refers. Most of his criticism, though valid as against the dogmas of the "school," is quite irrelevant as applied to the real Adam Smith. The nationalism of Adam Smith is so important that it is best treated in a separate chapter.

[1] Cf. *The National System of Political Economy* by Friedrich List (edition Longmans, 1904). Introductory Essay by present writer, p. xiv.

CHAPTER II

THE NATIONALISM OF ADAM SMITH

§ 1. *The Individual, the Family, and the Nation*

In the last edition of the *Moral Sentiments*, which was revised by the author just before his death, a new part was introduced,[1] which gives clearly his mature views on the relations of the individual to the family, the nation, and the world at large. The treatment of the family is interesting in connection with recent socialistic attacks, and gives a philosophical foundation to the common thought of the average Englishman. Adam Smith lays the greatest stress on the importance of the family relationships being intimate and continuous. The mere tie of blood is not enough. He goes so far, indeed, as to disapprove of the education of boys at distant great schools, and of young men at distant great colleges, a practice which he considered had hurt most essentially the domestic morals both of France and England. "From their parents' house they may, with propriety and advantage, go out every day to attend public schools: but let their dwelling be always at home.

[1] Part vi.

Surely no acquirement which can possibly be derived from what is called a public education can make any sort of compensation for what is almost certainly and necessarily lost by it."

It is beyond the scope of the present inquiry to consider the validity of Adam Smith's general philosophical ideas; but the point is, that properly to understand his economics we must at any rate understand his attitude as regards the moral foundations of society. His individualism wears a different aspect it we remember that he was a passionate admirer of home and home life; and that on his view from the home as the centre the sympathies of the individual are extended through ever-widening circles of friends and acquaintances, until in this way the family is naturally linked with the state or nation.

"The state or sovereignty in which we have been born and educated and under the protection of which we continue to live is in ordinary cases the greatest society, upon whose happiness or misery our good or bad conduct can have much influence. Not only we ourselves, but all the objects of our kindest affections, our children, our parents, our relations, our friends, our benefactors, all those whom we naturally love and revere the most, are commonly comprehended within it; and their prosperity and safety depend in some measure upon its prosperity and safety. . . . When we compare it with other societies of the same kind we are proud of its superiority and mortified in some degree if it appears in any respect below them. All

the illustrious characters which it has produced in former times, its warriors, its statesmen, its poets, its philosophers, and men of letters of all kinds, we are disposed to view with the most partial admiration and to rank them (sometimes most unjustly) above those of all other nations. The patriot who lays down his life for the safety or even for the vain glory of this society appears to act with the most exact propriety. . . . But though this sacrifice appears to be perfectly just and proper we know how difficult it is to make it and how few people are capable of making it. His conduct, therefore, excites not only our entire approbation but our highest wonder and admiration, and seems to merit all the applause which can be due to the most heroic virtue. The traitor, on the contrary, who in some peculiar situation fancies he can promote his own little interest by betraying to the public enemy that of his native country; who, regardless of the judgment of the man within the breast, prefers himself in this respect so shamefully and so basely to all those with whom he has any connection, appears to be of all villains, the most detestable."[1]

§ 2. *Adam Smith not Cosmopolitan.*

The following passage is still more remarkable as throwing light on Adam Smith's nationalism: "The love of our country seems not to be derived from the love of mankind. The former sentiment is altogether independent of the latter, and seems sometimes even

[1] *Theory of Moral Sentiments*, part vi. section ii. chap. ii.

to dispose us to act inconsistently with it. France may contain, perhaps, near three times the number of inhabitants which Great Britain contains. In the great society of mankind, therefore, the prosperity of France should appear to be an object of much greater importance than that of Great Britain. The British subject, however, who upon that account should prefer on all occasions the prosperity of the former to that of the latter country, would not be thought a good citizen of Great Britain. *We do not love our country merely as part of the great society of mankind;* we love it for its own sake, and independently of any such consideration."[1] Adam Smith, indeed, shows that the sentiment of nationality and patriotism may be pushed too far, and that the "mean principle of national prejudice is often founded upon the noble one of the love of our own country." He admits that France and England may each of them have some reason to dread the increase of the naval and military power of the other, but "it is beneath the dignity of two such great nations to envy the internal happiness and prosperity of the other, the cultivation of its lands, the advancement of its manufactures, the increase of its commerce, the security and number of its ports and harbours, and its proficiency in all the arts and sciences."[2]

It is important to observe, however, that even as regards material and economic interests on Adam Smith's view the prosperity of our own country

[1] *Theory of Moral Sentiments*, part. iv. section. ii. chap. ii. [2] *Ibid.*

ought to be our chief concern, though, as is shown in detail in the *Wealth of Nations*, we gain indirectly from the prosperity of our neighbours. "The love of our country seems in ordinary cases to involve in it two principles; first, a certain respect and reverence for that constitution or form of government that is actually established; and secondly, an earnest desire to render the condition of our fellow-citizens as safe, respectable, and happy as we can. He is not a citizen, who is not disposed to respect the laws and obey the civil magistrate; and he is certainly not a citizen who does not wish to promote, by every means in his power, the welfare of the whole society of his fellow-citizens."

§ 3. *Of Universal Benevolence.*

The chapter in this section which is entitled "Of universal benevolence"[1] completes the survey of the moral duties of the individual to others. "Though our effectual good offices can very seldom be extended to any wider society than that of our own country; our good will is circumscribed by no boundary but may embrace the immensity of the universe." . . . "Nor does the magnanimous resignation to the will of the great Director of the universe seem in any respect beyond the reach of human nature. In the greatest public, as well as private disasters, a wise man ought to consider that he himself, his friends, and countrymen have only been ordered upon the forlorn station of the universe. A wise man should

[1] *Theory of Moral Sentiments*, part vi. section ii. chap. iii.

surely be capable of doing what a good soldier holds himself at all times in readiness to do." But although "the idea of the divine being who rules the universe is of all objects of human contemplation by far the most sublime"; and although "we look with reverence on the man who is capable of absorbing himself in contemplation of this kind," we are told, as the conclusion of the whole matter, that "the most sublime speculation of the contemplative philosopher can scarce compensate the neglect of the smallest active duty. The administration of the great system of the universe is the business of God and not of man. To man is allotted a much humbler department: the care of his own happiness, of that of his family, his friends, his *country*."[1]

§ 4. *Two Popular Errors.*

It ought to be abundantly clear from the foregoing passages that popular opinion on Adam Smith's philosophy is fundamentally wrong on two points. In the first place, he did not inculcate any doctrines implying that every individual ought simply to look to his own interests, regardless of the interests of others; and in the second place, he did not maintain that the policy of nations ought to be directed solely by cosmopolitan considerations. These two ideas, as so often happens with popular delusions,

[1] Some writers have laid too much stress on Adam Smith's "natural theology" and the optimism supposed to be based on it. In particular, the reference to the "invisible hand" which directs private people towards the public good has been strained to absurd lengths. Adam Smith was the ardent admirer of Hume and Voltaire, and his theology was not altogether uncritical.

are in effect contradictory, except on the simple supposition that absolute *laisser faire* is best for the individual and also for humanity. This, however, so far as Adam Smith is concerned, is a greater delusion than the other two which it is advanced to reconcile.

The real Adam Smith never thought of the individual in isolation. The foundation of his whole system of moral philosophy is sympathy; the test of right conduct is the opinion of the impartial spectator; the individual is a member of a family; and through the family life he is brought in touch with ever-widening circles of friends and associates until he naturally regards himself as a member of the state. And here for most practical purposes the sympathies of the individual find their natural boundaries; although no doubt in moments of exaltation he may indeed seek to enter into communion with the spirit of the universe, and in the same way he may on occasion regard himself as a citizen of the world and a lover of all humanity.

§ 5. *Defence of more Importance than Opulence —the Navigation Act.*

It is remarkable, in view of the attacks that have been made by List and others on the cosmopolitan ideas of Adam Smith on economic matters, that it is in the *Wealth of Nations* itself that the nationalism of Adam Smith finds the most unreserved and unqualified expression. "The great object of the political economy of every country is to increase the

riches and the *power* of that country."[1] This reference to national power as the object and aim of national policy shows as always the influence on the mind of Adam Smith of historical development. That the reference is not merely a polite tribute to popular sentiment is shown by the application to the Navigation Laws. Here the leading idea is that though these laws may be prejudicial to the wealth of the nation they are to be approved on the very ground that "defence is of more importance than opulence." Writing of the famous Navigation Act of 1660 he points out that though England and Holland were not actually at war the most violent animosity subsisted between the two nations. "It is not impossible, therefore, that some of the regulations of this most famous Act may have proceeded from national animosity. They are as wise, however, as if they had been dictated by the most deliberate wisdom. National animosity at that particular time aimed at the very same object which the most deliberate wisdom would have recommended —the diminution of the naval power of Holland, the only naval power which could endanger the security of England."[2] The application of this remarkable passage to the present time *mutatis mutandis* is too obvious to need comment.

It is no doubt quite true that it was this very part of the old commercial policy which was first seriously attacked and modified by Huskisson (1825) and eventually the whole system was abandoned

[1] Book II. chap. v. [2] Book IV. chap. ii.

more than fifty years ago. Adam Smith also himself condemned the navigation acts so far as the colonies were concerned.

§ 6. *National Military Training as Part of the Education of Youth.*

But for the present we are concerned only with the ideas of Adam Smith on nationality and the advancement of national power. These ideas are even more forcibly illustrated, and have a much more intimate bearing on present problems as they are set forth in the chapter on the education of youth.[1]

One of the popular ideas on Adam Smith, founded apparently on a confusion between Adam Smith and Cobden, and a misunderstanding even of Cobden, is that he was a man who loved peace at any price, loved all countries more than his own, and hated the very idea of war. As a matter of fact, as shown in this chapter, Adam Smith regarded a military training as one of the most essential parts of the education of the youth of the nation. "The art of war is certainly the noblest of all arts." "A coward, a man incapable either of defending or revenging himself wants one of the most essential parts of the character of a man. . . . Even though the martial spirit of the people were of no use towards the defence of the society, yet to prevent that sort of mental mutilation and deformity and wretchedness which cowardice necessarily involves in it from spreading themselves through the

[1] Book v. chap. i. part iii. article 2.

great body of the people would still deserve the most serious attention of government; in the same manner as it would deserve its most serious attention to prevent a leprosy or any other loathsome or offensive disease, though neither mortal nor dangerous, from spreading itself among them." [1]

Again, after describing the advantages of natural liberty, he goes on to indicate broadly the most important functions of the state; the first duty imposed is that of defence—"the duty of protecting the society from the violence and invasion of other independent societies"; and this is spoken of as one of the duties of the state, "plain and intelligible to common understandings." In treating of the expenditure of the state the first charge made on the revenue is for the expenses of defence; and in dealing with this topic he applies, according to his custom, the historical method and discusses the merits and demerits of militias and standing armies, and shows an intimate acquaintance with the "noblest of all arts." [2]

§ 7. *The Soldier and the Statesman Compared.*

In the final addition to the *Moral Sentiments*, to which references have already been made, the glory of war is introduced in the discussion on the character of virtue. Adam Smith compares the relative merits of the statesman who is at the head of one of the great political parties with the soldier

[1] Book v. chap. i. part iii. article 2. [2] Book v. chap. i. part i.

who has the conduct of a great national war. "The leaders of the contending parties, though they may be admired by one half of their fellow-citizens, are commonly execrated by the other. Their characters and the merit of their respective services appear commonly more than doubtful. The glory which is acquired by foreign war is upon this account almost always more pure and more splendid than that which can be acquired in civil faction."[1] "The hero who serves his country successfully in foreign war gratifies the wishes of the whole nation, and is on that account the object of universal gratitude and admiration."

It must not be supposed, however, that the nationalism of Adam Smith was mainly dominated by ideas of territorial expansion and military glory. In this very chapter,[2] which gives his final views on national policy, we are told that the leader of a political party may sometimes render to his country a service much more essential and important than the greatest victories and the most extensive conquests. "He may re-establish and improve the constitution, and from the very doubtful and ambiguous character of the leader of a party he may assume the greatest and noblest of all characters, that of the reformer and legislator of a great state; and by the wisdom of his institutions secure the internal tranquillity and happiness of his fellow-citizens for many succeeding generations."

[1] *Moral Sentiments*, part vi. section ii. chap. ii. See also chap. iii. on "Self Command." [2] *Ibid.*

§ 8. *Adam Smith and Burke—Idea of Historical Growth.*

Adam Smith and Burke were close friends, and had much in common in their general ideas of political philosophy. The former is so well known as the destroyer of old systems, and the latter as the most thorough opponent of revolutions, that the fundamental agreement between the two thinkers may seem surprising. But Adam Smith himself is reported to have said of Burke that "he was the only man he had met with who thought as he did on the chief topics of political economy without previous communication."[1] And following on the passage quoted above from the last words of Adam Smith, we find an appreciation of the historical growth of a great state which is in exact harmony with the dominant idea in Burke's *Reflections on the Revolution in France* (published in the same year (1790) as this last edition of the *Moral Sentiments*). "The man," writes Adam Smith, "whose public spirit is prompted altogether by humanity and benevolence will respect the established powers and privileges even of individuals and still more those of the great orders and societies into which the state is divided. Though he should consider some of these as in some measure abusive, he will content himself with moderating what he often cannot annihilate without great

[1] Burke said of the *Wealth of Nations* when published: "Excellent; a dry abstract of which would convey no juster idea of it than the skeleton of a departed beauty would of her form when she was alive."—Prior's *Life of Burke*, p. 61 (George Bell, 1882).

violence. . . . He will accommodate as well as he can his public arrangements to the confirmed habits and prejudices of the people. . . . Like Solon, when he cannot establish the best system of laws, he will endeavour to establish the best that the people can bear."[1] It may be noted in passing that Adam Smith used precisely the same expression regarding the system of Corn Laws that prevailed in his day (13 Geo. III. c. 43): "With all its imperfections we may, perhaps, say of it what was said of the laws of Solon, that though not the best in itself it is the best which the interests, prejudices, and temper of the times admit of. It may, perhaps, in due time prepare the way for a better."[2]

Burke himself could not have attacked more vehemently "the man of system who seems to imagine that he can arrange the different members of a great society with as much ease as the hand arranges the different pieces upon a chessboard, but forgets that in the great chessboard of human society every single piece has a principle of motion of its own, and that if this is not taken account of the game of human society will go on miserably."[3]

Adam Smith allows that some general and even systematic idea of the perfection of policy and law may be necessary for directing the views of the statesman; but he must not insist on establishing, and establishing all at once, and in spite of all opposition, everything which that idea may seem to require.

[1] *Moral Sentiments*, part vi. section ii. chap. ii.
[2] Book IV. chap. v.
[3] *Moral Sentiments*, *loc. cit.*

This insistence by Adam Smith on the growth of the nation and the constitution throws a new light on his attitude towards the system of natural liberty in general and the particular manifestation of that system in the policy of international free trade.

He did not expect that the freedom of trade would ever be entirely restored in Great Britain; and he thought that any approach to it should be made very gradually. "The undertaker of a great manufacture who by the home markets being suddenly laid open to the competition of foreigners should be obliged to abandon his trade would no doubt suffer very considerably. . . . The equitable regard, therefore, to his interest requires that changes of this kind should never be introduced suddenly, but slowly, gradually, and after long warning."[1] And the case is still stronger if we consider the question from the point of view of the labour employed. "Humanity may in this case require that the freedom of trade should be restored only by slow gradations, and with a good deal of reserve and circumspection. Were those high duties and prohibitions taken away all at once, cheaper foreign goods of the same kind might be poured so fast into the home market as to deprive all at once many thousands of our people of their ordinary employment and means of subsistence."[2] "The very bad policy of one country may render it in some measure dangerous and imprudent to establish what would otherwise be the best policy in another."[3] This last quotation

[1] Book IV. chap. ii. [2] See below, p. 171.
[3] Book IV. chap. v., "Digression on Corn Laws."

refers, indeed, to a case of a special kind, namely, the danger to a small state under certain conditions of the exportation of its corn to meet the famine requirements of a larger state. But it serves to illustrate very forcibly Adam Smith's constant appeal to the idea of nationality.

§ 9. *Resumé.*

It is probable that if he had ever anticipated in the smallest degree the singular perversion by List, who accused him of neglect of national interests for cosmopolitan ideals, he would have made his nationalism still more prominent. But, in truth, Adam Smith took it for granted that in every country the idea of nationality was absolutely dominant. One more instance must suffice. In discussing the general question of colonial policy he considers the case of possible abandonment safeguarded by adequate commercial treaties. He shows that this alternative has certain advantages, even from the point of view of national power and wealth. But the idea is dismissed as not even worthy of practical consideration. "The most visionary enthusiast would scarce be capable of proposing such a measure with any serious hopes at least of its ever being adopted."[1] "No nation ever voluntarily gave up the dominion of any province how troublesome soever it might be to govern it, and how small soever the revenue which it afforded might be in proportion to the expense which it occasioned."[2] The presentation, however, of Adam Smith's views on

[1] Book IV. chap. vii. [2] *Ibid.*

colonial policy and imperial federation must be deferred. To understand this part of his argument account must be taken in the first place of his position on the employment of labour and the relations of labour and capital. Here again it will be found that the standpoint is unquestionably nationalist and not cosmopolitan.

CHAPTER III

OF LABOUR AND CAPITAL

§ 1. *Labour the Dominant Conception in the "Wealth of Nations."*

THE dominant conception in Adam Smith's whole treatment of the *Wealth of Nations* is unquestionably labour. The opening sentence runs: "The annual labour of every nation is the fund which originally supplies it with all the necessaries and conveniences of life which it annually consumes, and which consist always either in the immediate produce of that labour or in what is purchased with that produce from other nations."

Even List is forced to admit that this passage shows how clearly Adam Smith in general perceived that the condition of nations is principally dependent on the sum of their productive powers. The first book deals avowedly with the causes of the improvement in the productive powers of labour and the distribution of the produce amongst the different ranks and conditions of men in the society. The second book discusses in particular the relations of labour and capital, whilst in the third and fourth the influence on industry of political and economic systems is considered. In Adam Smith's

own words the object of these first four books is to explain in what has consisted the revenue of the great body of the people, or what has been the nature of those funds which in different ages and nations have supplied their annual consumption. The "annual produce of the land and labour" is an expression that is of as frequent occurrence in Adam Smith as the corresponding (and much more misleading) term the "national dividend" in writers of the present day.

The term "annual" indicates the continuous consumption and reproduction of the wealth, and the repetition of the term "labour" emphasises its fundamental importance.

§ 2. *Of Productive and Unproductive Labour.*

It would be easy to show by the citation of particular instances that labour is used by Adam Smith in the most extended sense. There are, in his view, two kinds of labour—productive and unproductive; each necessary to the welfare of the society, and each with a multitude of varieties. "There is one sort of labour which adds to the value of the subject upon which it is bestowed; there is another which has no such effect. The former, as it produces a value, may be called productive, the latter unproductive." Typical of the former is the labour of the manufacturer which fixes and realises itself in some vendible commodity. It is, as it were, a certain quantity of labour stocked and stored up[1] to be employed if necessary on some future occasion.

[1] Cf. the expression *festgeronnene Arbeitzeit* of the Socialists.

That subject, or what is the same thing, the price of that subject, can afterwards, if necessary, put into motion a quantity of labour equal to that which had originally produced it. Typical of unproductive labour is the labour of the menial servant which does not fix or realise itself in any vendible commodity. His services generally perish in the very instant of their performance, and seldom leave any trace of value behind them for which an equal quantity of service could afterwards be procured.

The distinction as drawn is quite clear and distinct; it answers to common usage, and calls attention to an important difference in the uses of labour.

§ 3. *Importance and Variety of Unproductive Labour.*

And Adam Smith, immediately after this account of unproductive labour, hastens to explain that the labour of some of the "most respectable orders in the society" is unproductive of any value "fixed and embodied in a vendible object." Their labour is technically unproductive, "because their service how honourable, how useful, or how necessary soever produces nothing for which an equal quantity of service can afterwards be procured."

In accordance with this view Adam Smith says that the sovereign, with all the officers of justice and war, who serve under him, the whole army and navy are "unproductive" labourers. And yet, according to the same Adam Smith such labour is essential to the very existence of the state. Unproductive

labour of this kind, in general, has a money value itself (though it does not create a value), and one of the great merits of Adam Smith is that he applies his theory of wages to "unproductive" as well as to "productive" labour, as, for example, when he compares the wages of the curate with those of the journeyman; and considers the connection between efficiency and reward in the case of education, the church, and the various learned professions.

Adam Smith is always intensely realistic, and the nations with which he deals are not composed only of "productive" labourers in the technical sense, but of other orders and sorts and conditions of men, who are at least of equal importance to the full national life.

Adam Smith's broad use of the term labour may be further illustrated by his application of the principle of division of labour to the class of men who are called philosophers or men of speculation.

"In the progress of society philosophy or speculation becomes like every other employment the principal or sole trade and occupation of a particular class of citizens. Like every other employment it is subdivided into a great number of different branches, each of which affords occupation to a peculiar tribe or class of philosophers."

It follows, at once, from this analysis of labour that the welfare of the nation as a whole is not to be considered solely from the point of view of "productive labour" in the narrow sense of the term. Still less is it to be considered solely from the point

of view of "accumulated values," which is the principal criticism so perversely and unjustly directed by List against Adam Smith. In his treatment of labour of every kind, Adam Smith is always a humanist; never a materialist.

§ 4. *Capital—Sustaining and Auxiliary.*

Although, as already stated, the dominant conception in the *Wealth of Nations* is labour, it is also shown that, from the beginnings of society, labour has required the aid of capital.

Many thousands of pages have been written on the meaning of capital, and even now new definitions are being attempted and new criticisms directed against the old. The main result of all this controversy seems to be that the term capital covers different ideas, both in economic theory and in the language of the market-place. Accordingly in using the term capital it is most important to take care that by the context, or by special use of adjectives, any ambiguity should be avoided.

Adam Smith, as usual with him in dealing with complex conceptions that have varied in the course of economic development, applies the historical method. His meaning becomes perfectly clear because he appeals to real nations in different stages of development in all periods and all the world over.

Capital is treated in the first place from the point of view of the assistance it affords to labour. Capital is required to sustain labour during the period of "waiting" for the results.

Not only must labour wait for the action of the forces of nature to have their effect, but whenever division of labour is adopted and extended it takes time before the parts of the processes can be assembled and the complete product sold and exchanged for the means of subsistence. Accordingly, a stock of consumable goods is required to enable labour of all kinds to wait.

But capital is equally required to assist labour in the actual processes of production. From the earliest times capital becomes of increasing importance as auxiliary to labour. With the progress of society, the forms of capital—the "capital goods" of the modern economist—become more and more complex and varied. Corresponding to division of labour there is a division of capital.

§ 5. *The Relations of Capital and Money.*

So long as we are simply considering the technical processes of production in the narrow sense of the term, as, for example, in the case of tilling land and waiting for the harvest, there is not much difficulty in realising the nature of the forms of sustaining and auxiliary capital.

But the act of production is not complete till the commodity is in the hands of the consumer.

Accordingly, trade is logically a part of production, if by production we mean the adaptation of material afforded by nature to the satisfaction of human wants.

With the progress of society, as Adam Smith

showed with an abundance of historical references of the most important character, exchange becomes of more and more importance. At the outset we are told that division of labour is limited by the extent of the market; and we cannot have markets, except of the most rudimentary kind, without the use of money.

One of the great merits of Adam Smith compared with his successors and also with his predecessors, is that he realises better than they do the uses and functions of money, both in practice and in theory. He attacked the mercantilists because, as the basis of their commercial policy, they had come to attach too much importance to the inflow of actual treasure into a country; and because in their theories, although they might begin with the real constituents of national wealth, in the course of their reasonings they forgot the things for the money measure. But one consequence of the success of this attack on a degenerate mercantilism was, as so often happens, that inferior writers carried the attack to an extreme. They seemed to imagine that unless they were always thinking with ideas of "things" they must be thinking with all the old fallacies about money. Accordingly, it became the fashion to speak of money as a mere medium of exchange, and mere measure of value, and of gold as a commodity like other commodities. One consequence of this neglect of the special attributes of money was that too little attention was given to markets, and the organisation of trade. It seemed to be taken for granted that

"once the things were there," once the technical processes were complete, the things would exchange themselves. Quite recently this maladjustment of emphasis has been corrected to some extent, but even now the appreciation of markets, and of the money power as the basis of production, is not so clearly realised as it was by Adam Smith.

On his view money is of fundamental importance, not only in connection with exchange and markets, but equally in the creation and the application of capital.

Capital is required to carry on both wholesale and retail trade; and wholesale and retail traders are both classed as productive labourers, even in the narrow sense of the term. They add to the value of the vendible commodities by increasing their utility in time or place.

§ 6. *Increasing Importance of the Money Attribute of Capital.*

In tracing the historical development of capital we observe the changes in the forms of "capital goods" of all kinds, but we also observe that the money attribute becomes of greater importance. This fact is made prominent by Adam Smith in his very definition of capital. Capital is that part of a man's wealth which is employed so as to yield him a revenue, as distinct from that part which is devoted to immediate consumption. But this revenue comes to him in the form of money (or credit which commands money). In a nation with a developed

money economy, the profit on capital can only be reckoned in terms of money. If the money valuation of the capital depreciates, although the machinery or building or whatever material form the capital may assume, remains as good as ever, the capital itself is so far depreciated. The forms of capital are continuously being consumed and reproduced, but they are only reproduced by passing through a money transformation. The products must be sold for money, and the money directed to the acquisition of the capital forms required. This is the reason why in speaking of any vendible commodity Adam Smith constantly uses the expression—the subject, or what is the same thing, the price of it.

§ 7. *Circulating and Fixed Capital.*

Capital can only obtain its revenue by being employed. Circulating capital yields its profit or revenue by changing hands or circulating. "The goods of the merchant yield him no revenue or profit till he sells them for money, and the money yields him as little till it is again exchanged for goods. His capital is continually going from him in one shape and returning to him in another." The fixed capital—*e.g.* machinery, improvements in lands, etc.—yields its revenue without changing hands, but here again it only yields a revenue by the sale of the product, and the wear and tear can only be made good also by the sale of the product.

The money attribute of capital is also manifest when we consider the special case of capital lent at

interest. "The stock which is lent at interest is always considered as a capital by the lender. He expects that in due time it will be restored to him, and that in the meantime the borrower will pay him a certain annual rent for the use of it. The borrower may use it either as a capital or as stock reserved for immediate consumption." Here it is plain that the capital must be lent, and returned in the form of money in the first place, and also that in general the interest is also paid in the form of money.

§ 8. *Mental or Immaterial Capital.*

One of the most notable features of Adam Smith's treatment of fixed capital is that he includes under it "the acquired and useful abilities of all the inhabitants and members of the society." Such talents can only be acquired by the maintenance of the acquirer during his education, study, or apprenticeship, and this involves a real expense which is a capital fixed and realised as it were in the person. This inclusion of mental or personal capital is in many ways interesting, and especially as showing Adam Smith's grasp of the principle of continuity, which we are apt to look on as a modern discovery. The conception of capital fixed and embodied in persons serves to show the continuity between productive and unproductive labour. Labour is productive (in the narrow technical sense) if it is used to make some vendible commodity which will command at least an equal quantity of labour. It is easy to see that the people of a country can only be kept up

from generation to generation, with all the qualities which differentiate civilised man from the lowest savages, if the labour of the parents or the elders is fixed and embodied in the children or the younger. The importance of this continuity in the mental capital of the human race was justly emphasised by List, and he only weakened his case by supposing he was contradicting instead of developing the ideas of Adam Smith. Even amongst savages, as a recent American writer has forcibly pointed out, the very existence of a tribe of wandering Indians depends on the stores of mental capital in the shape of knowledge of natural conditions locked up in the minds of the squaws. But in nations with a money economy the continuance of this mental capital is only possible (as in the case of material capital) through the continuous intervention of money. The enormous increase in recent years in national expenditure on elementary and secondary education is an illustration so large that it may well be called proof.

CHAPTER IV

OF THE RELATIONS OF LABOUR AND CAPITAL

§ 1. *Labour and Capital in Relation to the Annual Produce.*

THE relations of labour and capital, on the view of Adam Smith, are best seen if we consider, as he does, the relation of both to "the annual produce of the land and labour of the society," or "the great revenue of the body of the people," another substitute for our modern "national dividend."

The leading ideas may first be stated in Adam Smith's own words: "Though the whole annual produce of the land and labour of every country is no doubt ultimately destined for supplying the consumption of its inhabitants; yet when it first comes either from the ground or from the hands of productive labourers, it naturally divides itself into two parts. One of them, and frequently the largest, is in the first place destined for replacing a capital or for renewing the provisions, materials, and finished work which had been withdrawn from a capital; the other for constituting a revenue either to the owner of this capital as the profit of his stock or to some other person as the rent of his land. . . . That part of the annual produce of

the land and labour of a country which replaces a capital never is immediately employed to maintain any but productive hands. It pays the wages of productive labour only. . . . Whatever part of his stock a man employs as a capital he always expects it to be replaced to him with a profit. He employs it therefore in maintaining productive hands only; and after having served in the function of a capital to him it constitutes a revenue to them. Whenever he employs it in maintaining unproductive hands of any kind that part is from that moment withdrawn from his capital and placed in the stock reserved for immediate consumption. . . . Unproductive labourers, and those who do not labour at all, are all maintained by revenue."

This view is essentially also the modern view which emphasises the conception of a great stream or flow of national wealth which is used partly for keeping up and adding to the "productive powers" of the society and is partly used for immediate consumption or gratification. It is to be noted carefully that Adam Smith always draws a distinction between unproductive labourers and those who do not labour at all. And following up his conception of capital fixed in the natural and acquired abilities of the inhabitants of the country we see that a large part of productive labour may be regarded as employed in maintaining and adding to these forms of "living" capital. Tested either by cost of production or by earning capacity this living capital is of far greater value in any

modern civilised society than the dead or material capital.[1]

Again, if in the same way we develop the content of the phrase "the annual produce of the land and labour," we should arrive at the definition of "produce" given by Henry Sidgwick when he was searching for a term wider than the popular conception of wealth, which in general has an implied reference to material.

§ 2. *Meaning of Parsimony or Saving.*

There are, no doubt, expressions in Adam Smith which, taken without the context, and with all the reminiscences of fallacies born after his death, suggest false ideas of capital and of the relations of capital to labour. Take, for example, the sentence: "Parsimony and not industry is the immediate cause of the increase of capital." In the next sentence, however, we are told that "industry, indeed, provides the subject which parsimony accumulates"; and a little lower down we read: "What is annually saved is as regularly consumed as what is annually spent, and nearly in the same time too; but it is consumed by a different set of people." Adam Smith constantly uses the term fund where a modern writer (mindful of the pitfalls of the wages fund theory) would use the term "flow" or introduce in brackets a number of qualifications. But when we look beneath the surface—to the ideas the words stand for—it is plain that when he

[1] Cf. Essay on the "Living Capital of the United Kingdom" in *Strikes and Social Problems*, by the present writer.

speaks of "parsimony increasing the fund destined for the maintenance of productive hands" he only means foresight directing the flow of wealth to the satisfaction of future needs. "Both productive and unproductive labourers, and those who do not labour at all, are all equally maintained by the annual produce of the land and labour of the country." Here, at any rate, there is no suggestion of a fund put aside, and stored up for the future payment of the real wages of labour.

And when we examine Adam Smith's definite treatment of the wages of labour and the profits of capital, and of the relations of capital to labour, we also find that the ideas are what we are pleased to call modern and not early or mid-Victorian.

§ 3. *The Dependence of Labour on Capital.*

To begin with, Adam Smith points out that even in his day the cases are not very frequent in which a single independent workman would have a stock sufficient to purchase the material of his work and to maintain himself till it is completed. On the contrary, "in every part of Europe twenty workmen serve under a master for one that is independent."

That is to say, the command of capital is necessary to enable labour to work, and in general this command of capital is not in the power of the workmen themselves.

Capital and labour both being necessary for the annual production of the revenue out of which both

are paid, what are the principles which determine the distribution of the joint earnings? "What are the common wages of labour depends everywhere upon the contract usually made between those two parties (namely the masters and men) whose interests are by no means the same. The workmen desire to get as much, the masters to give as little, as possible. The former are disposed to combine in order to raise, the latter in order to lower the wages of labour."

He then goes on to show that in making the contracts or bargains as a rule the masters have the advantage. They can combine more easily, and the law authorises or at least does not prohibit their combinations, while it prohibits those of the workmen. It took the nation a century to recognise the essential truth of these positions, which in the meantime were obscured by crude theories of wages and of the relations of capital to labour.

§ 4. *Resumé of Adam Smith's Ideas on Labour and Capital.*

The main object of the present inquiry, as already explained, is not to justify the opinions of Adam Smith, or to make a comparison of his opinions with those of recent writers, but to apply some of his ideas to our actual problems, and especially to the problems connected with foreign trade and foreign investment of capital. For this purpose it is not necessary to give a summary of all Adam Smith's views on labour and capital, but it is necessary to understand his fundamental positions. And these, so far as yet

examined, are in accord with the latest developments. The annual produce of the land and labour—the great revenue of the body of the people—corresponds to the "national dividend." To keep up the dividend, the labour and the capital must also be kept up or continued in the same degree of efficiency. And in a healthy progressive society much more is produced than is requisite for this purpose; population increases and capital increases, and the wealth available for immediate consumption by the inhabitants of the country also increases. From the national point of view "the first object of political economy considered as a branch of the science of a statesman or legislator is to provide a plentiful revenue or subsistence for the people, or more properly to enable them to provide such a revenue or subsistence for themselves."

The distribution of the annual produce between the great social orders depends on their relative strength or on their power of making contracts. This again depends partly on the causes which may be brought under the terms demand and supply, and partly on the influence of law and custom with the force of law, which again depend largely on historical causes which go far back in their origins.

But though, in a sense, the interests of masters and men (or of capital and labour) are opposed, from another point of view they are in harmony. Both are interested in the increase of the joint product of their co-operation. And looking to the actual progress of nations Adam Smith arrives at the conclusion: "The wages of labour do not sink with the profits of

stock. The demand for labour increases with the increase of stock whatever be its profits; and after these are diminished stock may not only continue to increase but to increase much faster than before. . . . A great stock, though with small profits, generally increases faster than a small stock with great profits"[1]

Under any system in which private property and individual liberty are the essential bases of society —however much they may be modified by various moral or political ideals—capital and labour are mutually necessary and interdependent. The capital within any country, in order to preserve its existence, must be continuously restored and reproduced by labour. And equally under modern conditions labour can find no employment without the aid of capital.

Even supposing the socialist state were established there must be a reservation of stock for capital purposes, or the land would be afflicted with famine and misery.[2]

§ 5. *Complexity of Industrial Relations.*

It is equally obvious that under actual conditions (*i.e.* as contrasted with the socialist ideal) the direction of industry is in the hands of those who control the capital. Those again who control the capital look to profit as the guide, and profit again depends largely on the price to be obtained for the product and that again on the demand of the consumers. The con-

[1] Book I. chap. ix.

[2] Cf. Pareto, *Cours d'économie politique*, vol. ii. p. 366 *sq.*

sumers in the last resort are all who have any share in the great revenue of the society. With such a complex interaction of economic forces, it seems *prima facie* that it is extremely improbable that the national interests will be promoted simply by leaving individuals to do as they please.

§ 6. *Conflict possible between Individual and Public Interests.*

This possible conflict of the interests of the individual and the nation is always recognised and emphasised by Adam Smith. He does not take it for granted that, owing to a beneficent providence, the pursuit of self-interest naturally in all circumstances promotes the public good. To attain to that misty summit of optimism was left to the followers of Ricardo. The following passage from M'Culloch's Introduction to the *Wealth of Nations* (revised in 1838) shows very clearly the opposition between Adam Smith and the greatest and most extreme of the Ricardians. "But however excellent there are errors, and those, too, of no slight importance, even in those parts of the *Wealth of Nations* which treat of the production of wealth. So long as Smith confines himself to a statement of the advantages, resulting from the freedom of industry, and of the mischiefs occasioned by the frequent attempts to fetter its operations and to force it into certain channels in preference to others, his principles and reasonings are equally sound and conclusive; but they are less so in other instances. He does not say that those branches

of industry which are found to be most for the advantage of individuals are necessarily also most for the advantage of the public. His leaning to the system of the Economists—a leaning perceptible in every part of his work—made him so far swerve from his own principles as to admit that individual and public advantage do not always coincide. He contends that agriculture, though not the only productive employment, is more productive than any one else; that the home trade is more productive than a direct foreign trade; and the latter than the carrying trade. It is clear, however, that these distinctions are entirely imaginary. A state being nothing but a collection of individuals, whatever is most advantageous to them individually must be so also to the collective body; and it is obvious that the interest of the parties will always prevent them from engaging in manufactures and commerce unless they yield as large profits and are consequently as publicly beneficial as agriculture."

§ 7. *Weakness of Dogmatic Free Trade owing to Neglect of Adam Smith's Distinctions.*

These distinctions which M'Culloch regards as imaginary are with Adam Smith of vital importance. And when allowance is made for Adam Smith's use of popular language with ambiguities that must be interpreted by the context, they are seen to be reasonable and to point to important matters of fact.

In the opinion of the present writer, it is owing to the neglect of these distinctions that the theory of

"free trade" assumed a dogmatic simplicity and universality not recognised by Adam Smith; and it is the popular recognition of the reality of these distinctions that gives strength to the present attack on "free trade."[1]

[1] See next chapter.

CHAPTER V

OF THE DIFFERENT EMPLOYMENTS OF CAPITALS[1]

§ 1. *Four Modes of Employing Capital.*

UNDER the above title Adam Smith first of all discusses the different employments of capital in the home country. Four methods are cited. First, capital may be applied to agriculture and the extractive industries for the production of food and the raw materials of manufacture; secondly, to manufactures in the widest sense of the term implying the adaptation of these materials for consumption; thirdly, the capital may be applied to the distribution of these finished products by wholesale trade; and lastly, capital may be devoted to the retail trade.

"Each of these four methods of employing a capital is essentially necessary, either to the existence or the extension of the other three, or to the general conveniency of society. Unless capital were employed in transporting rude or manufactured produce from places where they abound to places where they are scarce, no more of either could be produced than

[1] This is the title of Book II. chap. v. of the *Wealth of Nations*; and might now be called the "forgotten chapter."

was necessary for the consumption of the immediate neighbourhood."

§ 2. *Trade Part of Production.*

In this way the persons whose capitals are employed in any of these four ways are themselves productive labourers.

The necessity of trade—both wholesale and retail—for completing the act of production is always emphasised by Adam Smith. He shows in the chapter on division of labour that by means of water carriage trade is carried on more easily than by land, and therefore markets grow up on the banks of rivers or on the sea-coast; and with the growth of the markets there is the growth of industry and of towns and cities. One of the best-known generalisations of commercial geography is that the cities of the world have grown up mainly through trade, and since Adam Smith wrote the cities of America have confirmed the induction. The great cities are the great centres of trade.

At the beginning of the third book he shows that the great commerce of every civilised society is that carried on between the towns and the country, and the gains of both are mutual and reciprocal. The nearer it is to the town so much greater is the improvement of the country; and that, in general, the improvement of the commerce of the towns has led to the improvement of the country, is the main argument of one of the best chapters in the *Wealth of Nations.*[1]

[1] Book III. chap. iv.

In the chapter[1] on rent we read: "Good roads, canals, and navigable rivers, by diminishing the expense of carriage put the remote parts of the country more nearly upon a level with those in the neighbourhood of the town. They are upon that account the greatest of all improvements." They are advantageous both to the towns and to the country; even to the country near the towns in spite of the increased competition.

§ 3. *Capital employed in Agriculture most advantageous to the Society.*

It seemed desirable to notice once more Adam Smith's views on the importance of trade in order to put in a proper perspective his views on agriculture. No proposition has been more criticised than that in which he says that "of all the ways in which a capital can be employed, the employment in agriculture is by far the most advantageous to the society."[2] And most of all objection is raised to one of the principal reasons assigned. "No equal capital puts into motion a greater quantity of productive labour than that of the farmer. Not only his labouring servants but his labouring cattle are productive labourers. In agriculture, too, nature labours along with man; and though her labour costs no expense its produce has its value, as well as that of the most expensive workmen." But with Adam Smith, as so often pointed out already, we ought always to apply the test of experience and not to consider how far his reasoning

[1] Book I. chap. xi. [2] Book II. chap. v.

may conform to later abstract propositions carefully guarded by hypotheses. The main contention is true not only of agriculture but of all the extractive industries in which "nature labours with man," and confirmation is found in the progress of the United States and the more recent expansion of Canada. In the controversy on the relative merits of the policy of the United Kingdom and the United States, we are always told to remember that the latter has the immense advantage of superior natural resources which is only another way of saying that in America nature labours with man to a greater extent than in England. And even as regards Great Britain the labour of nature or the aid of nature is one of the main causes of our industrial prosperity.

§ 4. *Other Social Advantages of Agriculture.*

Adam Smith, however, considered agriculture to be of special advantage to the nation on several other grounds, all of which seem reasonable and have weight in the present policy of various nations. He bestowed the highest praise on the qualities of labour that are called forth by agriculture. "After what are called the fine arts and the liberal professions, however, there is perhaps no trade which requires so great a variety of knowledge and experience." He refers to the innumerable volumes which have been written in all languages as well as to the knowledge that must be possessed by the common farmer. And recent experience confirms the view that of all the practical sciences that of agriculture

presents the greatest difficulties. Adam Smith also gives the highest praise to the ordinary agricultural labourers as compared with those of the towns. "How much the lower ranks of people in the country are really superior to those of the town, is well known to every man whom either business or curiosity has led to converse much with both."

If they had their deserts the labourers in the country would be paid much more highly than those in the towns, and it is worth noting that the main reason assigned for the lower remuneration of those engaged in agriculture is the greater power of combination possessed by the traders in the towns.

In making a bargain between the towns and the country, for the division of the gross produce of the two, the former have the greater bargaining power. In recent years the increased mobility of labour has raised the rates of wages in agriculture relatively, and no doubt the rise will be continued.

Adam Smith also commends agriculture from the national point of view because the capital that is acquired to any country by commerce and manufactures is always a very precarious and uncertain possession till some part of it has been secured and realised in the cultivation and improvement of its lands.

This last reason naturally leads to the consideration of the other differences in the employments of capital from the point of view of national advantage.

§ 5. *Distinction between Profit and Advantage.*

And in the first place we must realise that Adam Smith does not suppose that the advantage of the employment of capital is to be measured simply by the profit that is earned.

Throughout the *Wealth of Nations* profit and national advantage are distinguished, and very often indeed they are definitely opposed. In dealing, for example, with the monopoly of the colonial trade, the central point of the attack is that the monopoly of this trade had unduly raised the rate of profit, not only in that trade but in the country generally, and this rise in the rate of profit is shown to be a national disadvantage, and especially a disadvantage to labour. The argument will be examined later on, but, in the meantime, it is an excellent example of the distinction in idea, at any rate, between profit and advantage.

"The difference [in the advantage of the employment of capital] is very great according to the different sorts of wholesale trade in which any part of it is employed."

§ 6. *Home Trade more advantageous than Foreign Trade.*

All wholesale trade may be reduced to three different sorts: the home trade, the foreign trade of consumption, and the carrying trade.

The greatest national advantage is obtained by the employment of the capital in the home trade. The distinction turns on the fact of the employment of

the capital within the country and the encouragement of productive labour in the home country. The advantage is distinctly and emphatically a national advantage. The position is best illustrated by a concrete case. "The capital which sends Scotch manufactures to London and brings back English corn and manufactures to Edinburgh necessarily replaces by every such operation two British capitals which had both been employed in the agriculture and manufactures of Great Britain. The capital employed in purchasing foreign goods for home consumption, when this purchase is made with the produce of domestic industry replaces, too, by every such operation two distinct capitals; but one of them only is employed in supporting domestic industry. The capital which sends British goods to Portugal and brings back Portuguese goods to Great Britain replaces by every such operation only one British capital. The other is a Portuguese one. Though the returns, therefore, of the foreign trade of consumption should be as quick as those of the home trade the capital employed in it will give but one-half of the encouragement to the industry or productive labour of the country. But the returns of the foreign trade of consumption are very seldom so quick as those of the home trade. The returns of the home trade generally come in before the end of the year, and sometimes three or four times in the year. The returns of the foreign trade of consumption seldom come in before the end of the year and sometimes not till after two or three years. A

capital therefore employed in the home trade will sometimes make twelve operations, or be sent out and returned twelve times before a capital employed in the foreign trade of consumption has made one. If the capitals are equal, therefore, the one will give four-and-twenty times more encouragement and support to the industry of the country than the other."

This passage has been quoted at length in order to show that in Adam Smith's opinion the first test of the national advantage in the employment of capital is that the capital should be employed within the country. It is not a question of profit. Foreign employment of the capital may give greater profit. The advantage to the country itself, or the greater part of the advantage, consists in the consumption and reproduction of the capital by the productive labour of the country itself, and not by that of some other country.

§ 7. *Imports paid for by Exports.*

And it must not be supposed that Adam Smith was not perfectly aware of the elementary fact that (other items of international indebtedness being omitted) imports must be paid for by exports. This is clearly brought out in the passage following that just quoted. "The foreign goods for home consumption may sometimes be purchased not with the produce of domestic industry but with some other foreign goods. These last, however, must have been purchased either immediately with the produce of domestic industry or with something else which had

been purchased with it; for, the case of war or conquest excepted, foreign goods can never be acquired but in exchange for something that "had been produced at home, either immediately or after two or more different exchanges."

§ 8. *Varieties of Foreign Trade and their Relative Advantages.*

He goes on to say that the effects of such a roundabout trade of consumption are exactly the same as those of the direct foreign trade, except that the final returns are likely to be still more distant, as they must depend on the returns of two or three distinct foreign trades.

A roundabout foreign trade of consumption is therefore in general less advantageous to the nation than a direct trade, on the ground that the capital is kept longer out of the country.

Precisely the same principle is applied in determining the relative advantages of other kinds of foreign trade. The near trade, *e.g.* trade with France, is more advantageous than the distant trade, *e.g.* with India or America. And finally the pure carrying trade in which the capital of the country is employed in carrying between two foreign countries, and in its services is kept out of the home country altogether, is the least advantageous of all modes of the employment of capital. "That part of the capital of any country which is employed in the carrying trade is altogether withdrawn from supporting the productive labour of that particular country to support that of

some foreign countries. Though it may replace by every operation two distinct capitals, yet neither of them belongs to that particular country. The capital of the Dutch merchant which carries the corn of Poland to Portugal and brings back the fruits and wines of Portugal to Poland replaces by every such operation two capitals, neither of which had been employed in supporting the productive labour of Holland; but one of them in supporting that of Poland and the other that of Portugal."[1]

And here again it must not be supposed that Adam Smith did not realise that the ships of a country are part of its capital and the crews of those ships part of its productive labour. For he goes on to say: "When indeed the carrying trade of any particular country is carried on with the ships and the sailors of that country that part of the capital employed in it which pays the freight is distributed among and puts in motion a certain number of productive labourers of that country. It does not, however, seem essential to the nature of the trade that it should be so." In our own times one of the most frequent complaints against our merchant shipping

[1] The passage which immediately follows also illustrates very forcibly the distinction between profits and advantage. "The profits only return regularly to Holland and constitute the whole addition which this trade necessarily makes to the annual produce of the land and labour of that country."

A good example of the difference between profit and advantage is given in the chapter on Colonies (Bk. IV. ch. vii.). "In the trade, therefore, to which these regulations confine the merchant of Hamburg his capital can keep in constant employment a much greater quantity of German industry than it possibly could have done in the trade from which he is excluded." [The reference is to the exclusion from the distant trade of the British colonies.] "Though the one employment, therefore, may perhaps be to him less profitable than the other, it cannot be less advantageous to his country.'

generally is that it employs a large amount of non-British labour; and that British merchants may send goods between foreign countries in foreign ships.

It must be remembered also that Adam Smith gave great praise to the Navigation Laws on the ground that they gave encouragement to British ships and British shipping. In treating of the pure carrying trade he deals with the point that to Britain the carrying trade is of peculiar advantage, because "its defence and security depend upon the number of its sailors and shipping." But he replies the same capital may employ as many sailors and shipping either in the foreign trade of consumption or even in the home trade when carried on by coasting vessels as it could in the carrying trade. Then again he observes that the number of sailors and shipping which any particular capital can employ does not depend on the nature of the trade, but partly on the bulk of the goods in proportion to their value and partly on the distance of the ports between which they are to be carried; chiefly on the former of these two circumstances. "The coal trade from Newcastle to London, for example, employs more shipping than all the carrying trade of England, though the ports are at no great distance." He concludes, therefore, that "to force by extraordinary encouragements a larger share of the capital of the country into the carrying trade than would naturally go into it will not always necessarily increase the shipping of that country."

§ 9. *General Summary.*

The national point of view is made prominent in the general summary of the argument. "The capital employed in the home trade of any country will generally give encouragement and support to a greater quantity of productive labour in that country and increase the value of its annual produce more than an equal capital employed in the foreign trade of consumption; and a capital employed in this latter trade has a still greater advantage over an equal capital employed in the carrying trade." The question is looked at from the standpoint of the particular country concerned. "The riches and, so far as power depends upon riches, the power of every country must always be in proportion to the value of its annual produce, the fund from which all taxes must ultimately be paid. It ought, therefore, to give no preference or superior encouragement to the foreign trade of consumption above the home trade, nor to the carrying trade above either of the other two." At the time when Adam Smith wrote it was an essential part of the mercantile system to encourage exports. Such encouragement was given by treaties of commerce, by the monopoly of the colonial trade, and especially by the method of bounties on exports.

In our own day there has been a recrudescence of the idea that the prosperity of a country is to be measured by the growth of the export trade. Adam Smith's insistence on the importance of the employ-

ment of capital at home is aimed at this policy when he says that no artificial encouragement ought to be given to the foreign trade.

Again, in his view all foreign trade—except in the case where a country was purely passive—involved the export of part of the capital of the country, at any rate for a time. In proportion to the length of the time the capital was kept out of the country was the measure of its disadvantage.

The importance of the employment of capital at home is also shown in his estimate of the distribution of the advantage of foreign trade between different countries.[1] That country gains the greatest advantage in whose exports there is the largest proportion of native produce and the least of mere re-exports.

§ 10. *Importance of the Home Market.*

In considering generally the relations of the industry of the towns and that of the country—"the greatest and most important branch of the commerce of every nation is that which is carried on between the inhabitants of the town and those of the country"—a passage occurs of singular significance: "Whatever tends to diminish in any country the number of artificers and manufacturers tends to diminish the home market, the most important of all markets, for the rude produce of the land, and thereby still further to discourage agriculture."[2] Adam Smith's criticism

[1] Book IV. chap. iii. part ii.

[2] Book IV. chap. ix. This passage anticipates the main argument of Alexander Hamilton for the policy of protection of manufacturers in the United States, viz., that towns (with manufactures) must be developed in order to encourage agriculture.

of Mun, the great mercantilist, illustrates very forcibly the point in dispute: "The title of Mun's book, *England's Treasure by Foreign Trade*, became a fundamental maxim in the political economy not of England only, but of all other commercial countries. The inland or home trade the most important of all, the trade in which an equal capital affords the greatest revenue, and creates the greatest employment for the people of the country, was considered as subsidiary only to foreign trade. It neither brought money into the country it was said nor carried any out of it. The country, therefore, could never become either richer or poorer by means of it, except so far as its prosperity or decay might indirectly influence the state of foreign trade."[1]

§ 11. *Export Duties on Wool and Coal.*

Not only did Adam Smith maintain that the home employment of capital was generally more advantageous than any kind of foreign employment, but he accepted the principle that certain forms of capital should be retained specially for home use. Thus, for example, although he did not approve of the absolute prohibition of the export of wool (as enforced in his day), he approved of a very heavy export duty partly for the revenue to be obtained and partly on account of the encouragement given to the manufacture by the check imposed on the export and the consequent fall in the price. The whole passage is worth quoting as bearing on the very

[1] Book IV. chap. i.

similar case of the export duty on coal under present conditions. "Every different order of citizens is bound to contribute to the support of the sovereign or commonwealth. A tax of five or even ten shillings upon the exportation of every tod of wool would produce a very considerable revenue to the sovereign. It would hurt the interest of the growers somewhat less than the prohibition, because it probably would not lower the price of wool quite so much. It would afford a sufficient advantage to the manufacturer because, although he might not buy his wool altogether so cheap, he would still buy it at least five or ten shillings cheaper than any foreign manufacturer could buy it, besides saving the freight and insurance which the other would be obliged to pay. It is scarce possible to devise a tax which could produce any considerable revenue to the sovereign and at the same time occasion so little inconveniency to anybody." [1]

It would be easy to multiply instances of the importance assigned by Adam Smith to the employment of capital for the support and encouragement of

[1] Book IV. chap. viii. The average price of wool 1703-1790 was 8½d. per lb. (highest 13d., lowest 6d.), or about 20s. per tod of 28 lbs. (highest 30s. 4d. and lowest 14s.).

When Adam Smith made the final revision of his work (1783) the duty on the export of coal was 5s. per ton, in most cases more than the value at the pithead or even at the port. A duty was also imposed on the coal carried castwise between English ports. To this Adam Smith strongly objects as burdensome to consumers and detrimental to manufactures; and he says that "if a bounty could in any case be reasonable it might perhaps be so upon the transportation of coals from those parts of the country in which they abound to those in which they are wanted" (Bk. V. ch. ii.). This passage shows very clearly the importance, in his view, of using the natural resources of the country for the development of the home industries.

the productive labour of the home country, instead of that of foreign countries, but further elaboration seems needless in view of the passages already cited.

§ 12. *How can Adam Smith's Views on the Superior Advantage of Home Trade be reconciled with his advocacy of Free Trade?*

But at this point the question naturally arises: If in general the employment of capital at home is more advantageous to the nation than its employment in any form abroad, why should the nation or the sovereign power in the state not give particular encouragement to its own productive labour?

And in particular, if the employment of capital in agriculture is of all employments the most advantageous, why should a nation not give particular encouragement to that form of industry? The answer to these questions is of peculiar interest at the present time. Many of those who advocate the adoption by this country of differential duties in favour of home industries seem to think they have proved their case if they show that capital employed in home industries is more advantageously employed than if it is sent abroad, and that trade, for example, between Edinburgh and London is of more advantage to Britain than trade between London and Lisbon, or trade between Edinburgh and Hamburg. They do not appear to know that Adam Smith gave this illustration, and not only recognised generally the superiority in advantage of the home trade and of the home employment of capital, but

elaborated the distinction in a great variety of forms. Their arguments may be valid against some of the successors (in time) of Adam Smith, but they are worse than irrelevant as against Adam Smith himself. The nationalism of Adam Smith was much more robust than that of the present day, and as will be shown later, so was his imperialism.

The real difficulty as regards Adam Smith is this: Why, holding these very strong national and imperial ideas, did he destroy the old system in which these ideas had also been advanced? The answer is that, in his view, protection to the home market was in general either hurtful or useless, and that the monopoly of the colonial trade was injurious to the economic interest of landlord, capitalist, and labourer, and a source of national weakness instead of being a source of strength.

Those who perverted Adam Smith's system of natural liberty into the simple negative dogma of *laisser faire* got rid of the difficulty of answering these questions by saying that the great master was wrong in thinking there could ever be any other test of the advantage of employing capital than the test of profit; that in all cases equal profit gave equal advantage and greater profit greater advantage. Those, on the other hand, who accepted Adam Smith's ideas on the employment of capital rejected his ideas on freedom of trade, and argued in effect that he ought never to have destroyed the old system.

§ 13. *Bearing of the Answer on the Present Controversy.*

The consistency or the reverse of Adam Smith's arguments may perhaps appear to be a matter of historical interest only. But that is not so. The truth is that no great writer has taken so complete a survey of the complexity of the questions involved. He seems to be inconsistent, because people only take account of the parts of his argument which happen to suit their own narrower view.

An examination of his work in all its aspects ought to be the best introduction to an understanding of our present policy and of the value of the changes that are proposed.

It may happen that such an examination will show that the ideas with which Adam Smith destroyed the old system are no longer applicable to present conditions; and that if his views on nationalism and imperialism are to be effectually realised some parts of the old system must be restored, *e.g.* a certain moderate amount of protection must be given to home industry and a certain amount of preference to the colonies.

Or, it may happen, that in the course of economic development it is of even greater importance now than it was in the time of Adam Smith that in order to promote the real interests of the nation and the empire no restraints should be imposed or preferences given.

One thing at least ought to be abundantly clear.

Whether we look to Adam Smith's arguments in support of the general policy of freedom from restraints, or to his arguments in support of the important exceptions which he approves of, he certainly did not imagine that in all cases the interests of individuals are always in accord with those of the nation, or that national interests are always in harmony with those of the world. Crucial instances to the contrary have already been given, and the number might be indefinitely extended.

It is highly probable that such an examination of Adam Smith's reasons may give us ideas applicable to the present time. It may be that other ideas must also be introduced, and that the old ideas must be applied to new facts, but in the search for truth one great aid is to have guiding ideas. And whether true or false the ideas of Adam Smith have had a greater effect on the actual making of economic history than those of any other writer.

Note on Byles's "Sophisms of Free Trade."

The failure to distinguish (from the national stand point) between profit and advantage has been curiously persistent. In 1849 John Barnard Byles (later the author of the standard work on Bills of Exchange, and a justice in the Court of Common Pleas) published a book on the *Sophisms of Free Trade.* At the time (1849 being the year of the completion of the repeal of the Corn Laws) this work was remarkable for many acute criticisms of extreme *laisser faire.* But, perhaps, the most remarkable feature was the insistence on the position of Adam Smith that in general the home trade was more advantageous than the foreign, and bringing out as Adam Smith had done the difference between profit and advantage. This

work of Byles has recently been rediscovered and republished with notes and comments. The editors, W. S. Lilly and C. S. Devas, two well-known writers on political and economic science, and strong supporters of protection, throughout describe this position of Adam Smith (endorsed by Sir John Byles) as the *Home Trade Fallacy.* In commenting on Chapter IV. of Byles's book they say: "This chapter repeats the error of Adam Smith that home trade is *ipso facto* more profitable (*sic*) to a nation than foreign trade. It is Byles's main mistake, and exposed him to scornful refutation by Bowring and Lord Hobart. For purposes of reference we will label it the *Home Trade Fallacy,* and we will proceed to expose it. Adam Smith's remarks, then, which Byles quotes on the quicker returns and greater profits of the home trade are doubly incorrect." But neither Adam Smith nor Byles (in this matter his disciple) said that the home trade was more *profitable*; their contention is that it is more advantageous, and the terms are by no means synonymous.

Byles quotes at length the passage from Adam Smith given above, and restates the position in clear and vigorous language of his own, concluding with the reflection: "These observations of Adam Smith derive additional weight from the quarter from which they come. They are the admissions of the founder of the existing school of political economists on a point of vital importance, so vital that it affects the entire theory of free trade." Although Byles had already stated the argument very clearly and emphatically, he continues: "At the risk of being charged with prolixity and repetition I venture to invite the candid and serious attention of the reader to a further consideration of it." And he gives another rendering.

Other writers of the present day seem to think that if the home trade fallacy is not a fallacy, then, free trade must *ipso facto* be a fallacy. They accept the authority of Adam Smith on the advantage of home trade over foreign, but they never consider the arguments by which he tries to show that the national advantage is in general attained by freedom and not by restraints on foreign trade. These arguments are examined in the following chapters.

CHAPTER VI

THE REAL ADVANTAGES OF FOREIGN TRADE

§ 1. *Critique of Old Ideas of Advantages of Foreign Trade.*

THE mercantilists, whose maxims in political economy were accepted and acted on by all the nations of Europe up to the time of Adam Smith, laid an exaggerated stress on the value to a nation of its foreign trade. In opposition to this view Adam Smith insisted on the greater advantage in itself of the home trade, and showed that some of the principal advantages claimed for foreign trade were illusory, *e.g.* the acquisition of gold and silver by means of a favourable balance of trade. The refutation of the favourable balance theory—that the advantage of foreign trade was to be measured by the money balance due for the excess of exports over imports—was so complete that its success has been admitted by the strongest writers on the protectionist side (*e.g.* Cournot).[1]

So insistent indeed is Adam Smith on the

[1] "By an admirable piece of dialectics, full of vigour and flexibility, Smith utterly ruined the system known as the *balance of trade* which can no longer be sustained."—Cournot, *Mathematical Principles of the Theory of Wealth*, p. 164 (translation).

advantages of the employment of the capital of a nation at home that it might be thought the logical outcome of his argument would be a kind of Chinese isolation.

Apart from other reasons, however, he was well aware from the teachings of history, that England had gained enormously by the expansion of foreign trade, and he never held any theory which would not bear the test of experience.

It is true that all foreign trade involves the export of a certain amount of capital, but Adam Smith tried to show that if such export took place under natural conditions — that is to say, without any artificial encouragement as by bounties or monoplies of various kinds—the resulting trade would in general be of advantage to the nation.

§ 2. *The Natural Preference of Home to Foreign Trade.*

The fundamental position in this proof is that capital naturally seeks employment at home in preference to any foreign employment, and that it is only when the home channels are filled up that there will be an overflow of the surplus abroad. "Each of these different branches [of foreign trade] is not only advantageous but necessary and unavoidable, when the course of things, without any constraint or violence, naturally introduces it." The term "naturally" is suggestive of an *a priori* appeal to the system of natural liberty, but Adam Smith does not rely on any such appeal; he

advances purely economic arguments founded on experience.

§ 3. *Export of Surplus Produce Advantageous.*

"When the produce of any particular branch of industry exceeds what the demand of the country requires, the surplus must be sent abroad, and exchanged for something for which there is a demand at home. Without such exportation, a part of the productive labour of the country must cease, and the value of its annual produce diminish. The land and labour of Great Britain produce generally more corn, woollens, and hardware than the demand of the home market requires. The surplus part of them, therefore, must be sent abroad and exchanged for something for which there is a demand at home. It is only by means of such exportation that this surplus can acquire a value sufficient to compensate the labour and expense of producing it. The neighbourhood of the sea-coast and the banks of all navigable rivers are advantageous situations for industry only because they facilitate the exportation and exchange of such surplus produce for something else which is more in demand there."[1] In this way arises the direct foreign trade of consumption.

Again: "When the foreign goods which are thus purchased with the surplus produce of domestic industry exceed the demand of the home market, the surplus part of them must be sent abroad again and exchanged for something more in demand at home."[2]

[1] Book II. chap. v. [2] *Ibid.*

England, for example, it is shown, imports from Virginia and Maryland about seven times as much tobacco as there is a demand for in the English markets. If, then, the six-sevenths could not be sent abroad and exchanged for something more in demand at home, the importation of that part must cease, and with it the productive labour of all the people of Great Britain who are employed in making the goods to pay for the tobacco imported. "The most round-about foreign trade of consumption, therefore, may upon some occasions be as necessary for supporting the productive labour of the country and the value of its annual produce as the most direct."

Finally, we have the advantage, admitted under natural conditions, of the development of the carrying trade. "When the capital stock of any country is increased to such a degree that it cannot be all employed in supplying the consumption and supporting the productive labour of that particular country, the surplus part of it naturally disgorges itself into the carrying trade, and is employed in performing the same offices to other countries."

The carrying trade that arises in this way under natural conditions is the natural effect and symptom of great national wealth; but it does not seem to be the natural cause of it. Those statesmen who have been disposed to favour it with particular encouragement seem to have mistaken the effect and symptom for the cause. "Holland, in proportion to the extent of the land and the number of its inhabitants by far the richest country in Europe, has, accordingly, the

greatest share of the carrying trade. England, perhaps the second richest country in Europe, is also supposed to have a large share in the carrying trade, though probably some of it is more properly regarded as a roundabout trade of consumption." [1]

§ 4. *Export of Surplus Capital Advantageous.*

The example of Holland shows that capital may accumulate so rapidly and to such an extent that all the channels of trade are filled (even those of the carrying trade), and the country is obliged to export part of its capital abroad for foreign investment. "In the late war," says Adam Smith, "Holland gained the whole of the carrying trade of France," and yet the Dutch had such a redundancy of capital that they advanced loans to states and to private people in foreign parts at a rate of interest higher than that obtainable in Holland.[2] Adam Smith points out that some people in his day argued that the trade of Holland was decaying because the rate of profit was falling, but the true cause he suspected lay in the abundance of its capital. It was said that the Dutch at the time held forty millions of the English funds.

The case of Holland at the time of Adam Smith is very similar to that of England under present conditions. A large part of our capital is engaged in shipping, and a considerable amount in the pure carrying trade. But a still larger part is invested abroad or lent to foreign countries in public and private loans.

[1] Book II. chap. v. [2] Book I. chap. ix.

The fact that the rate of interest is lower in this country than in these foreign countries is at the same time the efficient cause of the export of our capital, and also a symptom that the capital exported is of the nature of a surplus. The profit that is obtained on these foreign investments is so much addition to the national revenue or dividend, and being redistributed in the country increases the demand for labour including productive labour.

Holland, in Adam Smith's day, had made the nearest approach to free trade (though still very remote from it), and not only derived its whole wealth, but a great part of its necessary subsistence from foreign trade including these foreign investments. As illustrating his breadth of view it may be mentioned that Adam Smith asserts that the republican form of government seems to be the principal support of the grandeur of Holland. The great mercantile families, the owners of great capitals, have some share or influence in the government, and are thereby induced to live in a country in which less profit is to be obtained. "The residence of such wealthy people necessarily keeps alive, in spite of all its disadvantages, a certain degree of industry in the country. Any public calamity which should destroy the importance of these wealthy merchants would make them remove their residence and their capital to some other country, and the industry and commerce of Holland would soon follow the capitals which supported them." [1]

[1] Book v. chap. ii. part ii. art. iv.

§ 5. *General Resumé of the Argument.*

To resume the main argument: Under natural conditions the capital of a country is first of all devoted to those industries in that country, especially agriculture, in which "nature labours with man," and there is a surplus value in the form of rent. The extent of the home trade (*i.e.* trade as distinct from industry or production in the narrow sense) is limited by the value of the surplus produce of the distant places within the country which have occasion to exchange their products. The foreign trade of consumption is limited by the value of the surplus products which can be exported to pay for the foreign goods. The extent of the carrying trade is only limited by the value of the surplus produce of all the countries in the world; and, accordingly, this branch of trade is capable of indefinite expansion as compared with the other two. We may place on the same footing as the carrying trade the investment of capital in foreign nations for all sorts of purposes, and compared with any one country the field for investment of the whole world is practically infinite.

At this point, however, a difficulty arises which has been generally overlooked, through the neglect of Adam Smith's distinctions on the different advantages of the employment of capitals.

After considering, in the way already explained, these relative advantages, Adam Smith concludes with the following remarkable statement of the

possible conflict of the actual interests of individuals with national interests.

§ 6. *The Employment of Capital by Individuals depends on Profit not on Advantage.*

"The consideration of his own private profit is the sole motive which determines the owner of any capital to employ it either in agriculture, in manufactures, or in some particular branch of the wholesale or retail trade. The different quantities of productive labour which it may put in motion, and the different values which it may add to the annual produce of the land and labour of the society, according as it is employed in one or other of these different ways never enter into his thoughts."[1] Taking a broad historical survey, Adam Smith finds that the policy of Europe —under which is included the influence of laws and customs of all kinds — has greatly interfered with the natural order in the progress of opulence. In particular agriculture, which is naturally the most advantageous of all employments of capital, has been discouraged to such a degree that "private persons frequently find it more for their advantage (*i.e.* as measured by the profit to be got) to employ their capitals in the most distant carrying trades of Asia and America, than in the improvement and cultivation of the most fertile lands in their own neighbourhood."[2]

[1] Book II. chap. v. [2] *Ibid.*

§ 7. *Influence of the Policy of Europe.*

Of such importance is this difference between national and private interests considered to be that Adam Smith devotes the two following books (namely the third and fourth) to the examination of the historical causes which have interfered with the natural order of progress.

The general result of this historical examination is that the policy of Europe has favoured the towns at the expense of the country. People in the towns have been enabled to get better profit than people in the country, mainly because the law has given them privileges of all kinds which are of the nature of monopolies, and it is against monopolies of all kinds that Adam Smith's attack is mainly directed. The position, so far, is precisely the same as that now prevailing in the United States and Canada.

The towns and cities, through the agencies of trusts, which have grown up under the protection of a tariff, are able to get the advantage in the general exchange of their produce with that of the country. The farmers, through this policy, pay more for their materials, and for their consumable commodities, and the towns pay less for the products of agriculture. That is the general complaint of the agricultural interests, both in the United States and in Canada. And, just as in the time of Adam Smith, the main cause is that the people in the towns can, and those in the country cannot, make effective combinations.

As regards the United Kingdom, since Adam

Smith wrote, most of the particular abuses which interfered with what he considered the natural distribution of capital, have been destroyed, and there has been a closer approximation to freedom in the application of capital apart from the direction of the state than he had deemed possible. Under these conditions a question of the greatest interest at present is, whether this natural distribution of capital is that which is most advantageous for the nation. For it is certainly as true as ever that the guide to the employment of their capital by individuals is the profit to be obtained.

§ 8. *Does Profit in general lead to Advantage?*

Much attention has recently been given to the investment of British capital in foreign states. Supposing that we still accept Adam Smith's ideas on the relative advantage of the employment of capital at home, are we entitled to say that the capital now exported is only a surplus?

Again, there has been an enormous development of all branches of foreign trade. Has this development taken place in such a way as to lead to an increase also in the home employment of capital, or has it been at the expense of the latter?

Adam Smith tried to show that under natural conditions, that is, apart from the influence of the state, individuals in seeking to promote their own interest would in general also promote that of the nation. If left to themselves, without any artificial system of preference or restraint, they would be

induced to employ their capital in that very order which is most advantageous to the society; first in agriculture, and then in all sorts of employment at home before the surplus was sent abroad.

§ 9. *The "Natural" Protection of Home Industries —especially of Agriculture.*

What, then, are these arguments on which Adam Smith relied, and have they been strengthened or weakened by the change in conditions?

"That order of things which necessity imposes in general (because subsistence is prior to conveniency and luxury), though not in every particular country, is in every particular country promoted by the natural inclinations of man. . . . Upon equal or nearly equal profits most men will choose to employ their capitals rather in the improvement and cultivation of land than in manufacture or in foreign trade."[1] The capital is more under their view and command, it is more secure than if entrusted to the risky credit and the uncertain laws of foreign countries,[2] and, besides, there are the pleasures of the country life and the attractions of the beauties of nature. The experience of England in the nineteenth century confirms this general position. As a matter of fact, the landlords of England have been content to invest capital in land and its improvement with a lower average return than is to be found in any other mode of employment. People who have made money in the towns still spend it in

[1] Book III. chap. i. [2] Book IV. chap. ii.

the country, and the profits of farming are lower than in any other industry.

But one part of Adam Smith's argument is no longer valid, or, to say the least, it has lost much of its force. In recent years the security for the investment of capital in foreign states has greatly increased and the organisation of credit has spread over the civilised world. There can be no question that as regards security a person can make a much safer investment of his capital by a proper geographical distribution over the whole world than by putting it in the permanent improvements of land which seemed so attractive to Adam Smith as to Arthur Young. Judging by the experience of the last quarter of a century, land is no longer regarded as the premier security for the investment of capital. The attraction of the country is, however, still so great that capital is applied to agriculture at very low rates of profit.

§ 10. *Other Home Industries.*

Adam Smith also argues that as regards home industries generally, the natural preference is so strong that capital will not be sent abroad in any way until all the home requirements are satisfied. Here, again, the low yield on home investments, and the relatively low profits of home trade, seem to show that it is only the surplus capital that is exported.

It must be noted, however, that Adam Smith himself always introduces the important proviso that it is only "upon equal or nearly equal profits" that

people will prefer those employments of capital which are most advantageous to the nation.

§ 11. *Difficulty if Foreign Trade gives Higher Profits.*

But the question arises: What if these less advantageous employments offer considerably higher profits? The individual thinks nothing of the national advantage of the employment of productive labour, as Adam Smith has so emphatically declared.

This difficulty is met by Adam Smith to some extent in dealing with the natural development of the trade with the colonies.

Trade with the British colonies in North America was an example of a very distant trade in which the returns of the capital employed were very slow; that is to say, according to Adam Smith's test of advantage, it was one of the least advantageous employments of the national capital (*i.e.* to the home country).[1] But he says capital would only be drawn into this distant and uncertain trade if it were attracted by a very high rate of profit. If, however, under natural conditions a very high rate of profit is obtainable from the purchase and sale of any kind of goods, that shows the price of these goods is higher than it should be according to the natural conditions of demand as compared with other things of the same kind. He argues, therefore, that in the circumstances of the society this high price for the colonial produce shows that the trade is understocked. If, then, under

[1] See below, Chapter XIII. § 15, on the advantage to the colonies.

the attraction of this high profit more capital were drawn into this trade prices would fall and the home producer who uses colonial raw materials would gain. The raw materials obtained from the colonies at the cheaper rates would be worked up by the home manufacturer, and a greater surplus would be available for export. This extension of the export trade would in turn lead to the increase of imports of things for which there was a demand for home consumption.

§ 12. *Reference to Experience.*

As usual in this argument Adam Smith was influenced by the actual conditions of British trade. In the eighteenth century, as Dr. Cunningham has so ably shown,[1] the progress of manufactures in general was checked by the dearth of raw materials. For these materials it was necessary to open up new sources of supply in distant lands.

This argument seems even stronger under present conditions. Our principal imports are articles of food and the raw materials of manufacture. The countries that supply these things are largely financed by the export of British capital. The high rate of profit obtainable through this application of British capital shows that prices are still higher than is necessary. The rubber industry gives a good illustration. Owing to the development of new uses for this material the price is high, profits are high, and British capital is being attracted to rubber plantations in distant lands.[2]

[1] *Op. cit.* vol. ii. p. 495.

[2] September 1909, plantation rubber sold at 9s. 7d. per lb., the average cost being reckoned at 1s. 6d. to 2s.

In a few years, as the result, the rubber will fall in price, and there will be a corresponding expansion in the various industries in which it is used. In the meantime also the higher profit directly increases the national dividend and also stimulates indirectly the creation of more capital. In this way the employment of home labour is directly encouraged by the growth of new industries, and the home country in spite of, or rather in consequence of this export of part of its capital, is kept fully supplied with capital for all possible home requirements.

§ 13. *Summary of Real Advantages of Foreign Trade.*

To summarise the argument: Adam Smith contends that capital is not exported under natural conditions for employment abroad until home needs are satisfied; the capital that goes abroad is an overflow. If such an overflow were not possible the capital would not be created. Again, if we look to the export trade considered merely as the exchange of home goods against foreign goods, the goods exported are in general of the nature of a surplus for which there is no demand in the home markets. This surplus is exchanged against the corresponding surplus of other nations with a mutual gain in utility.

In this way the productive powers of the home country are increased; there is, in the words of Adam Smith, an augmentation of industry. There is also an increase of consuming power on the part of the masses of the people. These are the two great real advantages of foreign trade.

So far, the question has been considered from the point of view of exports, which always means the export also, or the employment out of the country, of a certain amount of capital.

Up to the time of Adam Smith statesmen had tended to overestimate the advantages of large exports mainly because they supposed that the result would be an increase of treasure and thereby an increase of national power. The export trade was specially, stimulated particularly the trade to the countries with which the balance was supposed to be favourable. Adam Smith showed that such artificial encouragement was not desirable. To some extent the ideas which he attacked have survived and remained operative down to our own times, *e.g.* bounties on exports—open and concealed—are still given, to the detriment of the nations concerned, as the history of the sugar bounties shows; but no nation frames its policy as regards exports simply with the view of increasing the supply of metallic money.

§ 14. *Adam Smith's Attitude not purely Negative.*

But although Adam Smith maintained that the export trade did not need special and artificial encouragement, his attitude was by no means purely negative. If any country by prohibitions or high duties prevents the importation of some of our manufactures it is a matter worthy of deliberation whether we should not impose retaliatory duties with a view to compelling them to open their markets.

"There may be good policy in retaliations of this kind when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniency of paying dearer during a short time for some sorts of goods." [1]

There can be no question here of the admission by Adam Smith of the principle, although it is true that in the following sentences he shows the difficulties of carrying out the policy mainly owing to the imperfections of the statesmen to whom the negotiations must of necessity be entrusted. If, however, the statesmen are strong enough and the inconveniency is really only temporary, there is no doubt that Adam Smith would approve of retaliation as a practical means of putting the export trade on a fair footing.[2] In showing that the export trade needs no special favour Adam Smith relies mainly on his central idea that the employment of capital at home is more advantageous.

§ 15. *Extension of the Argument on Home Trade to Imperial Trade.*

This idea has an important bearing on one of the practical controversies of the present. As will be shown in detail later on Adam Smith was not only a nationalist but an imperialist.[3]

It is only the natural development of his central

[1] See below, Chapter XI. § 14. [2] *Ibid.*
[3] See Chapter XIV.

idea to say that the employment of capital within the empire is more advantageous than its employment in foreign states. From this point of view exports to the British dominions and possessions are on the same footing as home trade. The permanent investment of British capital in a foreign state *e.g.*, in a loan to its government for war or other unproductive purposes is, on Adam Smith's showing, the least advantageous of all the employments of the capital of the country. Even if the capital is employed by the foreign state productively, the share of the advantage obtained by this country is relatively small, and practically the gain is confined to the interest that is obtained. If, however, the same amount of capital had been sent to some part of the empire the industry, and with it the power of the empire, is so much increased.

But we certainly cannot say that British capital naturally flows into the various parts of our widely extended empire and satisfies all their requirements before it overflows into foreign countries.

The mobility of capital and its retention within the empire would be greatly increased by an imperial union with free trade between the constituent parts, *i.e.* if the empire became *de facto* the "home" country.

This point will come up for consideration in connection with the question of colonial policy, but in the meantime the central position of Adam Smith must be examined from another point of view.

§ 16. *Distinction between Active Export Trade and Passive Import Trade.*

So long as we export surplus goods which would not be made at home unless there was a foreign market for their disposal, and so long as we import in return things which we cannot make at all or only at a disadvantage, there is the augmentation of industry and increase of consuming power that are claimed by Adam Smith as the real advantages of foreign trade.

But suppose, that instead of beginning with an active export trade on our part, we begin with a trade in which we are passive and receive the imports of the foreigner. Is it not possible that these foreign imports may displace some home industry and convert a home trade into a foreign trade of consumption?

This leads up to the famous case of protection to native industries; and having regard to Adam Smith's central idea so often emphasised, the answer is by no means so simple as the supporters of dogmatic *laisser faire* would imply.

CHAPTER VII

MEANING OF PROTECTION TO NATIVE INDUSTRIES

§ 1. *The term Protection not used by Adam Smith.*

JUST as the expression "free trade" is often used as equivalent to "natural liberty" or *laisser faire*, so also the term protection is often used to cover all the artificial encouragements or hindrances that may be adopted by the state for the regulation of trade, especially foreign trade.

Such a vague usage is unhistorical, and can only lead to confusion. As it happens the term "protection" is not used by Adam Smith at all, except in the sense of military defence, and the provision of security to life and property. He constantly uses the term "free trade," but he has no single expression which can be considered as the antithesis. The mercantile system which he attacked, as the dominant commercial policy of his day, was highly complex, and neither the original aims nor the methods by which they were to be attained could be summarised under the term "protection." The term which Adam Smith most generally uses as the opposite of free trade is "monopoly"; *e.g.* he says that "monopoly of one kind or another seems to be the sole engine of

the mercantile system." The centre of his attack is certainly monopoly; but he also attacks other mercantilist ideas that are not covered by the term monopoly; *e.g.* the undue importance attached to money, and the consequential ideas of a favourable balance of trade; ideas which led to peculiar commercial treaties in which the leading idea was neither protection to the home producer nor reciprocity.

§ 2. *Used in narrow Sense by Alexander Hamilton.*

The term protection (with its corresponding adjective protectionist) was used by Alexander Hamilton (1791) in a narrow sense. The object of his *Report on Manufactures* was to show, first, that it would be of immense advantage to the United States to become a great manufacturing nation, and, secondly, to indicate the methods by which this end might be attained. In this second part of his task he appeals to the experience of other nations which have succeeded in manufacturing industries. In discussing these methods adopted by other countries he puts first "Protectionist duties—or duties on those foreign articles which are the rival ones of the domestic ones intended to be encouraged." [1]

But besides this method he discusses ten others, *e.g.* prohibitions of rival articles or duties equivalent to prohibitions; prohibitions of the export of the materials of manufacture; bounties; premiums; exemption of raw material of manufacture from taxa-

[1] Hamilton's *Works* (Federal edition), vol. iv. p. 143.

tion, etc.; some of these other methods being explicitly approved of by Adam Smith.

§ 3. *Meaning depends on Correlation.*

Protection is one of those terms so common in economics in which the meaning depends on the correlative term with which they are associated. If we interpret the term to mean the support or encouragement of native industries (and native labour) by the employment of capital within the home country instead of in foreign countries, then we may say that the object of protection was approved of by Adam Smith. As already shown the test of economic advantage, to which he constantly appeals, is the employment of the productive labour of the country within the country. To keep capital in existence (as measured by the practical test of the continuance of its own value) it must be continuously reproduced after being consumed, and it is this reproduction of the forms by which the value is continued which gives employment to the productive labour. This productive labour keeps up the auxiliary capital in a state of efficiency, replaces the sustaining capital, and also assists in turning out the great stream of consumable things which Adam Smith speaks of as the annual produce of the land and labour.

With Adam Smith the local habitation of the capital during the process of consumption and reproduction is of fundamental importance. The employment of a given amount of capital in home trade or industry is so far directly more advantageous than

its employment in foreign trade or industry, although the latter may yield equal or even greater profit. This idea of national advantage is not only admitted by Adam Smith, but is developed to an extent that has never been approached by any subsequent writer. If this is protection Adam Smith is the blackest of all protectionists.

Conversely, however, it may be presumed that if on balancing the arguments for and against restrictions on foreign imports, Adam Smith was satisfied that the interests of the home producers were best promoted by freedom from restraints, he is a free trader against whom the usual protectionist arguments are simply irrelevant. Or putting it otherwise, the difference between "protection" and "free trade" becomes a difference not of principles but of methods; and in this case a reconciliation ought to be possible on an appeal to the facts.

As will appear in the chapter on the exceptions to free trade admitted by Adam Smith, these are in themselves of vast importance; but apart from these definitely stated exceptions his whole treatment depends not on the reiteration of a simple dogma (or assumption), but on a careful balancing of opposing considerations.

§ 4. *Distinction between Objects and Methods of Protection.*

The distinction between the ultimate objects of any commercial policy and the methods by which that policy may be achieved is of vital importance. If

the objects are fundamentally different, if they appeal to different ideals, to different standards of morality, or to different prejudices of race or nationality and the like, reconciliation is not possible until the ideals and prejudices are altered. But if there is no such fundamental opposition in ideals, if the dispute is only as regards methods, then a reconciliation ought to be possible after a scrutiny of the facts by impartial authority (*e.g.* in this country a Royal Commission). Adam Smith treats of what is now commonly called protection to native industries under the title:[1] "Of restraints upon importation from foreign countries of such goods as can be produced at home."

§ 5. *Taxes for "Revenue" and for "Monopoly" distinguished.*

And it should be carefully observed that in dealing with this question he does not consider the general policy of taxes on imports. At the conclusion of the chapter he says: "How far it may be proper to impose taxes upon the importation of foreign goods in order not to prevent their importation, but to raise a revenue for Government, I shall consider hereafter when I come to treat of taxes."[2] Adam Smith certainly approved of custom duties as a source of revenue, although he showed that the revenue might be increased by a better system, and he suggested reforms which were afterwards adopted with great advantage by the United Kingdom. So far from

[1] Book IV. chap. ii.

[2] See Book V. chap. ii.

disapproving of a customs revenue, he proposed that the British system of customs should be extended with some modifications to the rest of the empire, so that a great customs union might be established with free trade within its borders.[1]

A careful examination of the *Wealth of Nations* also shows that Adam Smith was not opposed to the customs duties of a kind and degree that would give some advantage to the home producer over his foreign competitor. He states that when an excise duty is imposed in the home country a corresponding customs duty ought also to be imposed, but he does not state in the same emphatic manner that corresponding to every customs duty there ought to be an excise precisely equivalent.[2] On the contrary, in several passages, he indicates that some advantage might properly be given to the home producer.

Writing of the customs duties that prevailed in his day he says: "The taxes which at present subsist upon foreign manufactures . . . have, the greater part of them, been imposed for the purpose not of revenue, but of monopoly, or to give our own merchants an advantage in the home market. By removing all prohibitions and by subjecting all foreign manufactures to such moderate taxes as it was found from experience afforded upon each article the greatest revenue to the public our own workmen might still have a considerable advantage in the home market; and many articles which at present afford no revenue to government

[1] See below, Chapter XIV. [2] See below, Chapter XVI.

and others a very inconsiderable one might afford a very great one."[1]

It is clear from this, and from similar passages, that Adam Smith had no objection to customs duties not exactly balanced by an excise, provided that such duties yielded a considerable revenue; if they did yield such a revenue they could only do so by entering into the home market and destroying the monopoly of the home producer; and it was against this monopoly that his attack was directed.

The opening sentences of the chapter now under consideration (Bk. IV. ch. ii.) confirm this view. "By restraining either by high duties or by absolute prohibitions the importation of such goods from foreign countries as can be produced at home the monopoly of the home market is more or less secured to the domestic industry employed in producing them." This was the system which prevailed in England at the time and this is the system which he attacked; and it is universally admitted that the great evil of protection at present is this evil of monopoly.

Yet even on this point the opinion of Adam Smith is by no means unrestrained. Writing of the protection of infant industries he says: "By means of such regulations, indeed, a particular manufacture may sometimes be acquired sooner than it could have been otherwise, and after a certain time may be made at home as cheap or cheaper than in the foreign country."

Provided there is a sufficiency of competition in the home country—and competition means the absence

[1] Book v. chap. ii. art. iv.

of monopoly—restraints on imports lose one of their worst effects.[1]

§ 6. *Adam Smith's Treatment not Abstract or Hypothetical.*

It must be remembered that Adam Smith was never content merely with abstractions and hypotheses, but always sought for verification in the actual experience of nations and especially in the actual practice of his own times and of his own country. He found in existence a complicated mass of restrictions and prohibitions the immediate aim of which was to secure the monopoly of the home market to the home producer. He set himself to prove that in general the whole system was either useless or hurtful for the attainment of the ultimate object—this ultimate object being the promotion of native industries and the increase of the national wealth. It was with protection of the most extreme kind that Adam Smith had to deal: with "high duties and absolute prohibitions" intended not for revenue, but for the effective exclusion of rival commodities from the home markets.

Accordingly, it is the method of monopoly which he attacks and not the principle of the encouragement of home employment.

§ 7. *Gross and Net Revenue.*

Ricardo[2] complains that Adam Smith constantly exaggerates the importance of gross revenue compared

[1] Cf. Hamilton, quoted below, Chapter XVI.

[2] *Principles of Political Economy*, chap. xxvi.

with net revenue; but the exaggeration, if it be such, may be explained by the fact that Adam Smith was concerned to show that the masses of the people lived on the consumption of the gross revenue and that it was the aim of the monopolists to secure a maximum net revenue. In general, in the case of monopoly, the maximum net revenue can only be attained by the contraction of the gross revenue.

These are now the commonplaces of economic theory. But the application of any theory to practical cases is never commonplace. Suppose, for example, that it is admitted that under present conditions a certain amount of unemployment in England may be ascribed to the displacement of English labour by the admission of foreign goods. This means that capital is not applied to the same extent to this form of industry; and the proximate reason is that it does not obtain enough profit. Accordingly, the first condition for the restoration of the industry is that it shall be made profitable. The primary object then of protection must be profit, although the ultimate object may be the wages of labour.

In the recent debates on the new tariff in the United States the ostensible aim of the "reformers" was to fix the duties in such a way that having regard to the cost of production in competing countries a reasonable profit should be left to the American producer. This was the practical test. The consequent employment of labour was taken for granted or not considered at all. In Australia, where the labour

party has more political power, attempts have been made in recent legislation to secure the advantages of protection directly to labour.

§ 8. *Profit on Capital requisite for the Employment of Labour.*

In treating of the relative advantages of employing capital in different modes and in emphasising the superiority in this respect of the home employment Adam Smith always introduces the proviso "on equal or nearly equal profits." The employment of home labour is the ultimate test of advantage, but a necessary condition is that the capital should get its profits. If capital cannot obtain the usual or minimum profits in the home country either it will not be accumulated and reproduced or it will be sent abroad. Accordingly, the only way of giving any artificial encouragement to the employment of labour within the country is to give an artificial encouragement to the retention of capital. That means, in the common phrase, to make the employment of the capital remunerative. In this way every protective system, however loudly it may proclaim the interests of labour, must in the first place look to the increase of profit. If an industry is to be maintained in any country secure against foreign competition the profits must be secured as the primary condition.

If the necessary profit is secured by protection it can only be obtained by raising the price. But this rise in price, if it yields the least exceptional profit, increases natural competition within the country.

This again reduces the price below the level of decent remuneration (to the capital), and the natural remedy is the creation of a definite monopoly in the form of a trust.[1] In this way protection leads to monopoly and monopoly in general to permanently higher prices. We are accustomed to think that monopoly is a modern result of production on a large scale; but monopoly "against their own countrymen" pervaded the whole commercial system attacked by Adam Smith.

If it is said that protection (*i.e.* the exclusion of foreign goods), may be afforded without raising prices then the difficulty is to see how capital can be induced to give more employment. If capital is being already exported (as at present from the United Kingdom) in large masses, how can it be induced to remain unless prices rise to a remunerative height?

§ 9. *New Theory of Protection.*

The development of the idea that in order to encourage home labour by protection the profit on capital must first of all be increased, leads to a new theory of protection; a theory quite in accordance with the most recent modes of presenting economic principles.

National production in all its branches requires the co-operation of the three great agents—land (typical of nature), labour, and capital. The land is always there even if derelict; the labour, like the poor, is also always there; but the floating capital

[1] Cf. *The Trust Problem*, by J. W. Jenks, chap. iii.

is here to-day and gone to-morrow as profit calls, and the fixed capital wastes away, unless it can be replaced with a profit. Profit or no profit the proletariate will increase, but unless the capital can be retained at a profit the labour cannot find employment. Accordingly it may be maintained that in order to increase "the aggregate satisfaction" of the community capital ought to be induced to stay—for a consideration.

Such a consideration might take one of two forms; a bounty or a protective duty.

"I love to see the tall chimneys smoke" is still the best apology for a bounty. It is true that a bounty can only be raised by taxation. If, however, the taxation is levied on the richer classes, the "aggregate satisfaction" is increased by making some of their superfluous wealth wander, state-directed, to the poor. And it may be argued that on this plan the poor are twice blessed; for the wealth diverted instead of giving a small relief to a small number of unemployed causes capital to stay in the country and to give employment at fair wages to a far greater number.

A protective duty by the exclusion of foreign competition enables the home producers to raise their prices, and in that way their profit. The protective duty is equivalent to a bounty obtained by the taxation of the consumer. If the consumers are relatively wealthy and the producers relatively poor, there is again an increase of the "aggregate satisfaction" and a double blessing of the poor.

If the articles protected (and raised in price) are consumed by the poor, in effect they themselves pay the bounty which bribes capital to stay. But on the theory of "aggregate satisfaction" the payment may be to their advantage, because even in this case they gain the employment; it is as if they paid something by way of insurance against unemployment.

It may be contended that the same result might be obtained by a natural fall in the wages of the industry affected by the foreign competition. But such a fall might be prevented by the action of trade unions; and in any case to be permanent it must be part of a general fall, *i.e.* particular wages are adjusted to the general level.

§ 10. *Protection and Socialism.*

It follows from the argument of the last two sections that protection logically carried out leads to socialism. Socialism is a term of vague import, but for the present purpose it may be taken to mean the control of the capital and labour by the state. If the state intervenes, under present conditions, to give artificial profit to some favoured industry on the ground that it will give advantageous employment to labour, surely it may be said that the state ought to see that the industry selected is the best, and that the ultimate object is secured. The people of the United States are in many respects, owing to a variety of causes, the least socialistic of modern nations, and yet the cry that the nation ought to own the trusts is quite popular, and will only be

stilled if some effective means of control is invented. The national ownership of the trusts is described as the natural result of evolutionary socialism. The experience of continental nations is equally apposite. Socialism is much more widely prevalent in protectionist countries than in the United Kingdom. And the reason is that the monopoly of capital is more obvious and is apparently more detrimental to labour.

If the ideal of socialism is once approved it may be approached by other avenues. The method of aiding the poor by first raising the profits of the rich does not appeal to the average socialist; his method is direct taxation and direct management of land and the instruments of production; he would gladly show the protectionist a more excellent way if the employment of the poor is the goal.

Adam Smith, however, considered the question of protection from the point of view of a society in which capital is owned and managed by individuals who are guided by profit and not by ideas of promoting the "aggregate satisfaction." And society is still so constituted that if we wish to be practical we must follow his example.

CHAPTER VIII

PROTECTION TO NATIVE INDUSTRIES

§ 1. *Difficulty of the greater Advantage of Employment of Capital in Home Trade.*

In dealing with "protection to native industries," in the sense of "restraints upon importation from foreign countries of such goods as can be produced at home," Adam Smith has to meet the difficulty that on his view capital employed in home industries or in home trade is *prima facie* more advantageously employed than when devoted to any kind of foreign trade or investment—that is to say, with his usual proviso, "upon equal or nearly equal profits."

If capital is employed in some home industry that has reached the limits of expansion imposed by the demand in the home market, it is advantageous that an export trade should be developed so that the industry may be conducted on a larger and more economical scale, and also by natural expansion give additional employment to home labour. The surplus is exported and exchanged for something for which there is a demand.

In this case the country employs more capital at home so far as that particular industry is concerned,

and any growth of the export trade under the conditions assumed, gives, in general, more employment to home labour and capital.[1]

§ 2. *Possible Displacement of Home Industries by Foreign Imports.*

But when we consider imports made into a country it does not follow on Adam Smith's principles that the expansion of the import trade will necessarily mean a corresponding increase in home industry. It is quite possible that the new import may displace the product of some old industry instead of being exchanged against a surplus that would naturally be exported.

Suppose, for example, that before the trade is opened, a million pounds worth of English manufactures were exchanged against a million pounds worth of English corn. If a million pounds worth of corn are now imported (at a cheaper rate per unit), the English manufactures formerly given in exchange to the English producers of corn will now be given to the foreigner.

In this case it is not the surplus of an expanding manufacture that is exchanged for foreign goods that cannot be produced at home. On the contrary, a foreign trade displaces a home trade. And the *immediate* effect on Adam Smith's views is a disadvantage.

That the *immediate* effect would be a disadvantage (measured by the test of the employment

[1] See Chapter VII.

within the country of capital and labour) is confirmed from other cases taken by Adam Smith.

If, for example, an industry has been dependent on protection, then he argues that the freedom of trade should only be restored by slow gradations. The implication, of course, is that the displaced labour and capital can only gradually find other employment. In the same way Adam Smith's support of retaliation depends on the idea that the recovery of a great market is worth the cost of the temporary inconvenience. It is assumed that the check given to the export trade by the foreign duties cannot be met at once by the opening up of new markets, or by the application of the productive power to other industries. Indeed, in this case, the implication as regards the employment of capital goes farther, and the recovery of the great market is supposed to be a permanent advantage. If another foreign market could always be obtained, why submit to the losses of retaliation?

And when a foreign import displaces some home product, it is plain that in the normal case another market cannot at once be found for that particular product, and the capital and labour must be diverted into a new industry. But in general the transfer cannot be made immediately, nor can it be made without a loss of the capital already specialised.[1]

[1] "If the free importation of foreign manufactures were permitted, several of the home manufactures would probably suffer, and some of them perhaps go to ruin altogether, and a considerable part of the stock and industry employed in them would be forced to find out some other employment. [But the freest importation of the rude produce of the soil could have no such effect upon the agriculture of the country.]" Book IV. Chap. ii. The sentence in [ ] is noticed below.

It is clear that Adam Smith did not hold the opinion that it was in all cases an immediate advantage to the nation if a new import displaced some old home product from home consumption.

It is, however, also equally clear from the conclusions of his argument that he did not think it was generally desirable to prevent the import of foreign goods in order to preserve the home market for the home producer. He notices, indeed, some very important exceptions, but these very exceptions may be used so far to prove the rule.

What, then, are the reasons which at the time convinced Adam Smith that "restraints upon the importation from foreign countries of such goods as can be produced at home" were in general not desirable from the national point of view?

These reasons are given at length in the second chapter of the fourth book of the *Wealth of Nations*. Under present conditions this chapter deserves a careful critical examination.

§ 3. *Protection in Great Britain in Time of Adam Smith.*

To begin with, he shows that at the time by far the greater part of the industries of the country were actually protected "by high duties or absolute prohibitions" against foreign competition in the home markets. The importation of live cattle and salt provisions was prohibited, so that the graziers had a monopoly of the market for butcher's meat. The high duties on corn in times of moderate plenty also

amounted to a prohibition. With regard to manufactures, the importation of foreign woollens and of silks was prohibited, linen was making great strides towards the same privilege, and many other sorts of manufactures had obtained in Great Britain "altogether, or very nearly, a monopoly against their countrymen." "The variety of goods of which the importation into Great Britain is prohibited, either absolutely or under certain conditions greatly exceeds what can easily be suspected by those who are not well acquainted with the laws of the customs." [1]

He admits that this monopoly of the home market frequently gives great encouragement to the particular species of industry that enjoys it, and also that frequently a greater amount of the labour and stock of the society is turned to this industry than otherwise would have gone to it.

But he goes on to say: "Whether this monopoly tends either to increase the general industry of the society or to give it the most advantageous direction is not perhaps altogether so evident." [2]

§ 4. *Protection of Advantage to Particular Industries.*

It is absolutely necessary to see clearly the difference between the interests of particular industries and the interests of the nation at large.

It cannot be doubted—that is Adam Smith's own

[1] On the number of duties and prohibitions which survived in 1842 see the famous report of that year.

[2] In the first edition "certain" is used in place of "evident," as pointed out in Dr. Cannan's edition.

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expression—that frequently the particular industries may, under such protection, grow to larger dimensions than otherwise would be the case, and attract to themselves a larger amount of labour and capital than if they were subject to foreign competition in the home market.

In the light of recent history this is an admission of serious importance. In all the great staple industries the tendency has been towards production on a larger and larger scale; and for large-scale production in highly developed countries it is contended that the possession of the home market—in Adam Smith's own words "the most important of all markets"—is an immense advantage.

Again, it is contended by modern supporters of protection that the great staple industries, that can be carried on on a large scale, from the nature of the case, and the very meaning of the terms, are limited in number; this is not a matter of opinion but a matter of arithmetic. Accordingly, if the principal staples of a country are benefited by protection—if they become larger than otherwise would be the case—that means, it is argued, that the greater part of the industries of the country are also benefited.

This expansion, which is rendered possible by the possession of the home market, also gives—it is maintained—encouragement to the expansion of foreign trade; and no one has shown more clearly than Adam Smith that the natural exports from a country are the surplus products of the home industries. With the augmentation of industry and the

extension of division of labour—Adam Smith's terminology for our law of increasing return—such surpluses naturally arise, and unless they are exported the growth of the industry must be checked.

§ 5. *Adam Smith's first Answer: Industry limited by Capital.*

Adam Smith, however, tries to show that, although particular species of industry are encouraged by protection against foreign competition in the home market the general industry of the society is prejudiced.

His first argument is that which has become so familiar to students through the expression and expansion it has received in John Stuart Mill's four fundamental propositions on capital.

Adam Smith's own statement is, however, perfectly clear, and is free from the paradoxes which led Mill to assert that "demand for commodities is not demand for labour," and that the demand for labour is "the wages fund."

"The general industry of the society," says Adam Smith, "can never exceed what the capital of the society can employ. As the number of workmen that can be kept in employment by any particular person must bear a certain proportion to his capital, so the number of those that can be continually employed by all the members of a great society must bear a certain proportion to the whole capital of the society, and never can exceed that proportion. No regulation of commerce can increase the quantity of industry in any society beyond what its capital can maintain.

It can only divert a part of it into a direction into which it might not otherwise have gone; and it is by no means certain that this artificial direction is likely to be more advantageous to the society than that into which it would have gone of its own accord."

The relations between capital and labour, or, more generally, the relations of capital to industry, have already been examined.[1] All experience shows that one necessary condition of the existence and the expansion of any particular industry is the command of the necessary capital; and in the same way capital is necessary for the continuance and development of the general industry of the society. There are other requisites and other equally necessary conditions, *e.g.* land and labour, but Adam Smith, at this stage, confines himself to the influence of capital.

It is one thing, however, to admit that capital is one of the superior limits to the expansion of industry, or the employment of labour, and quite another to say that the amount of capital available for the industry of any society is itself always limited—in the sense, namely, that any increase of employment at one place or in one industry can only mean a diminution elsewhere. Mill himself pointed out that though industry is always limited by capital it does not always come up to that limit, although he seems to have forgotten the qualification when he came to consider the influence of demand and the relations of capital to labour. In the passage quoted Adam Smith only says that it is "by no means certain" that the artificial direction

[1] See Chapter VI.

given to industry by the commercial regulations of the state are more advantageous than the natural distribution.

And if we look to his general treatment of capital we see that he never takes it for granted that the amount of capital available for home industry in any society is always limited. On the contrary, his central position is that, under natural conditions, it is only when the home industries have got all they require that the surplus overflows into the less advantageous channels of foreign trade.

It is quite certain that the United Kingdom, under present conditions, has at its command a far larger amount of capital than can be profitably employed in home industries and trade. Recent estimates[1] show that we have already three thousand millions of capital invested abroad; and apart from this there is the large amount involved in carrying on our foreign trade. The rate of export of capital also seems to be increasing, and yet there appears to be no diminution in the amount that is retained at home. That is to say the capital exported directly and indirectly is of the nature of a surplus.

Under these conditions, then, it cannot be said that the amount of capital available for home industry is limited, and that an artificial expansion of one industry (by means of protection) can only mean the abstraction of capital from some other home industry;

[1] "Great Britain's Capital Investments in other Lands," by G. Paish, *Journal of Royal Statistical Society*, September 1909.

The market value of the public securities negotiable on the Paris Bourse at the end of 1908 was £2,629,520,000 French, and £2,705,800,000 foreign (*Economist*, August 21, 1909).

it may come from what would otherwise have been exported.

§ 6. *Second Answer: Home Industries naturally protected.*

Here Adam Smith introduces the argument that no artificial encouragement of home industries is needed, because under natural conditions every individual endeavours to employ his capital as near home as he can, and consequently as much as he can in the support of domestic industry. To this statement is added the condition that is always assumed as essential, namely, "provided always that he can obtain the ordinary or not a great deal less than the ordinary profits of stock." The arguments already noticed are advanced to show why the individual has this preference for the employment of capital as near home as possible. The different cases are examined with the result that: "Home is the centre round which the capitals of the inhabitants of every country are continually circulating, and towards which they are always tending, though by particular causes they may sometimes be driven off and repelled from it towards more distant employments.[1] But a capital employed in the home trade, it has already been shown, necessarily puts into motion a greater quantity of domestic industry, and gives revenue and employment to a greater number of the inhabitants of the country than an equal capital employed in the foreign trade of consumption; and one employed in the

[1] See above, Chapter I., on the influence of Newton.

foreign trade of consumption has the same advantage over an equal capital employed in the carrying trade. Upon equal or only nearly equal profits, therefore, every individual naturally inclines to employ his capital in the manner in which it is likely to afford the greatest support to domestic industry, and to give employment and revenue to the greatest number of people of his own country."

This passage is remarkable for the insistence on two points: first, that for capital to be employed at home it must obtain the ordinary or nearly the ordinary rate of profit; and secondly, that the employment of capital at home is most advantageous.

And here the difficulty arises. Suppose the introduction of some foreign import takes away the profit of the home producer may this not lead to a diminution of domestic industry? Before the foreign trade was opened there was an interchange of products and a replacement of capitals within the country; but after the foreign trade is established one of the capitals is a foreign capital, as in the example already noticed of the trade between Edinburgh and London compared with that between London and Portugal.

§ 7. *Third Answer: Effect of Protection on "The Annual Produce of the Land and Labour of the Society."*

This difficulty is met by Adam Smith by taking account of the effect on the national dividend or the annual produce of the land and labour. And this brings to the surface the arguments that at present

are most used in support of free trade, and which historically had most influence.

The test of the relative advantages of different modes of employing an equal amount of capital is not merely the quantity of productive labour that is put in motion; but "likewise the value which that employment adds to the annual produce of the land and labour of the country."[1]

On Adam Smith's view of national advantage it is true that the labour of the country should be as fully employed as the amount of capital will allow; but it is equally true also that this labour should be *employed in the most economical or most effective manner.*

If we look merely to the employment of labour we fall at once into the popular fallacy of "making work," which, if acted on, except in temporary emergencies, is always prejudicial to the interests of labour as a whole. There are endless examples of the evil effects of this most popular of all fallacies: the "work made" by the old Poor Law for the unemployed and the partial recrudescence of a similar remedy in our own times; the "work made" by some of the old regulations of Trade Unions; the opposition to the introduction of machinery on account of the displacement of labour—these are illustrations on a large scale of the national loss involved in "making work"; which in other words in general means "wasting labour."

Adam Smith disposes of the "making work" fallacy

[1] Book II. chap. v., first sentence.

by taking account of the whole productive forces of the society which are engaged in getting the great annual revenue for the people. And his argument here gives what is still the best presentation of the most popular argument for free trade, the argument, namely, from cheapness. "If a foreign country can supply us with a commodity cheaper than we ourselves can make it, better buy it of them with some part of the produce of our own industry, employed in a way in which we have some advantage. The general industry of the country being always in proportion to the capital which employs it will not thereby be diminished no more than that of the above-named artificers; but only left to find out the way in which it can be employed with the greatest advantage. It is certainly not employed to the greatest advantage when it is thus directed towards an object which it can buy cheaper than it can make. The value of its annual produce is certainly more or less diminished when it is thus turned away from producing commodities evidently of more value than the commodity which it is directed to produce. *According to the supposition that commodity could be purchased from foreign countries cheaper than it can be made at home*; it could therefore have been purchased *with* a *part only of the commodities*, or what is the same thing with a *part only of the price of the commodities*, which the industry employed by an equal capital would have produced at home, had it been left to follow its natural course. The industry of the country, therefore, is thus turned away from a more to a less

advantageous employment; *and the exchangeable value of its annual produce* instead of being increased according to the intention of the lawgiver must necessarily be *diminished* by every such regulation."

The words italicised suggest the essence of the argument, and it will be observed that even in this, the most familiar of all the free trade arguments, the popular interpretation is generally more simple than that of Adam Smith himself. Adam Smith does not content himself by saying that it is best for the consumer to buy in the cheapest market. In this passage he does not even mention the consumer.[1] As always, labour is made fundamental; labour and the reward of labour. If we take account of the whole labour of the country there is an advantage to that labour if we import goods that can be bought at a cheaper price than we can make them; because in this indirect way we employ less labour in making the particular things in question, that is to say, we avoid "making work" by prohibitions; and with the labour set free we make "something else" instead of "work." The argument is clenched by the famous illustration of the wine made from Scottish grapes. "By means of glasses, hotbeds, and hot-walls very good grapes can be grown in Scotland, and very good wine can be made of them, too, at about thirty times the expense for which at least equally good can be brought from foreign countries. Would it be a reasonable law to prohibit the importation of all foreign wines merely to encourage the making of claret and Burgundy in Scotland?"

[1] See next chapter.

In an extreme case like this—or that of Bastiat's candlemakers' petition against the sun, perhaps suggested by it—every one would probably admit that making work by artificial restraints would not increase employment and its reward, when the question is regarded from the national point of view and not from the point of view of particular interests.

§ 8. *Fourth Answer: Displaced Labour and Capital will find Employment at Home.*

In economics the principle of continuity warns us that a difference in degree may often amount, for practical purposes, to a difference in kind. In other words, the argument from extreme cases is often fallacious.

Adam Smith, however, in this case pushes the argument of the grapes to the extreme limit. "But if there would be a manifest absurdity in turning towards any employment thirty times more of the capital and industry of the country than would be necessary to purchase from foreign countries an equal quantity of the commodities wanted, there must be an absurdity, though not altogether so glaring, yet exactly of the same kind, in turning towards any such employment a thirtieth, or even a three-hundredth part more of either." But as the following sentences show, this argument implies (as in the former extreme case) that the displaced capital and labour can find other and more advantageous employment. For he continues: "Whether the advantage which one country has over another be

natural or acquired is in this respect of no consequence. As long as the one country has those advantages, and the other wants them, it will always be more advantageous for the latter to buy of the former rather than to make. It is an acquired advantage only which one artificer has over his neighbour who exercises another trade; and yet they both find it more advantageous to buy of one another than to make what does not belong to their particular trades." [1]

It is clear that Adam Smith's argument in favour of free imports can only be reconciled with his position on the relative advantage of the home employment of capital and labour, if it is proved that in fact (and not merely as an assumption) the capital and labour displaced by the foreign import will find employment at home. If the result were that the capital would be sent abroad, or if it would not be replaced as it gradually was worn out, and if labour was unemployed or forced to emigrate, the effect on the total of home industry would in general be disadvantageous, according to Adam Smith's ideas of advantage, *i.e.* from the national standpoint.

In this connection it is noteworthy that Adam Smith states that "in manufactures a very small advantage will enable foreigners to undersell our own workmen, even in the home market." [2] And accordingly he argues that it is merchants and manufacturers (as contrasted with agriculturists) who

[1] Book IV. chap. ii. [2] *Ibid.*

derive the greatest advantage from the monopoly of the home market.

It must be repeated that the guide to the employment of capital is always profit. If, then, a foreign import cuts away profit, the home industry is checked or stopped, and what becomes of the capital displaced depends on the profit to be obtained in other things. It is quite possible that with an old country the natural opening would be found in some other place. And that is, from Adam Smith's point of view, a most important consideration. As well as a "something else" there is always a "somewhere else." And for the nation the place is of vital importance.

§ 9. *Appeal to Experience necessary.*

Adam Smith, looking always to facts, makes it an essential condition for the retention of capital in the home country that it should obtain equal, or very nearly equal, profits as compared with employment elsewhere. It might, no doubt, be an advantage to the country if it were retained, and merely continued its own existence (as is the case with a good deal of the capital sunk in landed estates). But in the normal case, apart from social considerations, it is commercial considerations, measured in terms of profit, which determine the retention or migration of capital.

If, then, by a small duty the home market can be retained for our own workmen,—if the small duty gives enough profit to retain the capital—the duty would, on his principles, be an advantage, unless it

can be shown that the capital, if displaced, would find at least equally advantageous employment at home in something else.

And here the important point to observe is that we cannot escape from the appeal to experience. We must look for confirmation of the general principle to the actual history of the development of home industries in competition with foreign imports; and for the support of our present policy we must appeal to present facts. If official statistics do not suffice, a special Royal Commission should be appointed.

If by such an appeal to present experience we should find that, as the result of foreign competition, our home industries were decaying and capital being exported, or that the higher forms of industry were being displaced by the lower, or that industries necessary to social welfare or to national power were discouraged, whilst those which ultimately would prove detrimental were stimulated; in these and similar circumstances, according to the principles of Adam Smith, it might be the duty of the state to "direct private people how they should employ their capitals," and to that end to interfere, by means of protective duties, or bounties, or other aids and restraints. But before such intervention could be approved on his principles we should have to show that the state could by the means suggested remedy the evils complained of without bringing in greater evils. And this consideration brings into view the strength of the negative argument for natural liberty.

And it is evident that Adam Smith laid quite as much stress on the weakness of state control as on the benefits of individual freedom (see Chapter X.).

In the meantime, however, the relation of the consumer to the producer is of so much importance that a somewhat more elaborate treatment seems desirable than was possible in the general survey undertaken in the present chapter (see next chapter).

CHAPTER IX

THE PRODUCER AND THE CONSUMER

§ 1. *That Cheapness is a Benefit and Employment a Necessity to the Consumer: both Truisms.*

To those who accept the popular dogma that under all conditions it is advantageous for a nation to buy in the cheapest market, whether that market be in the home country or elsewhere, Adam Smith's treatment of protection to native industries will seem needlessly elaborate. And to the same people an appeal to experience in the form of economic history and statistics (or the Report of a Royal Commission) will also appear to be as superfluous as in the case of a proposition of Euclid.

It is, indeed, a truism that if any number of people have a certain definite amount of money to spend they will get more commodities exactly in proportion to their cheapness; but it is equally a truism that if they have no money they will get no things at all except in the way of charity. And as Adam Smith observed: "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner, but from their regard to their own interest.

We address ourselves, not to their humanity, but to their self-love; and never talk to them of our own necessities, but of their advantages."[1] But to get anything by way of exchange something must be given, and in any modern society that something is money (metallic or representative); and the money can only be obtained in the ordinary case by some form of employment. Employment, then, is a pre-requisite of consumption. He that will not work neither shall he eat, said the apostle of charity; and he that has no work shall have no meat, is the variant of our modern man of business.

Accordingly, the dogmatic popular argument of cheapness is countered by the protectionist argument of employment. The one is as much a truism as the other; and as every one knows general truisms, like the axioms and postulates of Euclid or the common law, are quite useless until they are combined with particulars; and in the combination lies the practical difficulty.

Adam Smith looks at the problems of foreign trade from the point of view of the producer as well as from that of the consumer, and applies equally the test of employment and the test of cheapness.

There are, indeed, certain passages in the *Wealth of Nations* which have often been quoted to show that, in his opinion, it was only requisite to look to the interests of the consumer. A passage very frequently extracted and interpreted without reference

[1] Book I. chap. ii.

to the context occurs in the general summary of the attack on the mercantile system.

§ 2. "*Consumption the sole End and Purpose of all Production*": *Critical Examination of.*

"Consumption is the sole end and purpose of all production; and the interest of the producer ought only to be attended to only so far as it may be necessary for promoting that of the consumer. The maxim is so perfectly self-evident that it would be absurd to attempt to prove it. But in the mercantile system the interest of the consumer is almost constantly sacrificed to that of the producer; and it seems to consider production and not consumption as the ultimate end and object of all industry and commerce."[1] That the very meaning of production is the adaptation of things to the wants of man—the putting utility into things or adding to the utility—and that utility itself means the power to satisfy a want—have long since become the commonplaces of political economy. But Adam Smith's reference to the interest of the producer as entirely subordinate to that of the consumer has been altogether misunderstood and misapplied.

The term "producer" has been interpreted to mean the "productive labourer," and it has been supposed that Adam Smith meant by this assertion that so long as commodities were produced as cheaply as possible the conditions under which the work was done by labour might be disregarded; that in the

[1] Book IV. chap. viii.

interest of the consumer labour itself was to be made as cheap as possible, and if, for example, the labour of little children was cheaper than that of men it was to be preferred. In this way, out of the perversion of maxim, a maxim so self-evident that it came very near the explication of a definition, there arose the opposition to all the long series of reforms for the improvement of the conditions of labour which have marked the economic progress of the nineteenth century.

But, as so often pointed out, the teaching of the *Wealth of Nations* cannot be understood from a few isolated sentences. And with Adam Smith there is the less justification for this perversion of popular dogmatism, because he always makes his meaning perfectly clear by a context illuminated by facts. The sentence under examination follows immediately on a passage in which he severely condemns the laws which prohibited the emigration of skilled workmen: "It is unnecessary to observe how contrary such regulations are to the boasted liberty of the subject, of which we affect to be so very jealous; but which in this case is so plainly sacrificed to the futile interests of our merchants and manufacturers," who in effect wanted a buyer's monopoly of labour, to use the modern term. And after a summary of the modes in which, under the mercantile system, the interests of the consumer have been sacrificed to those of the producer, we have as the conclusion: "It cannot be very difficult to determine who have been the contrivers of this whole mercantile system; not

the consumers we may believe, whose interest has been entirely neglected; but the producers, whose interest has been so carefully attended to; and among the latter class our merchants and manufacturers have been by far the principal architects. In the mercantile regulations which have been taken notice of in this chapter[1] the interest of our manufacturers has been most peculiarly attended to: and the interests, not so much of the consumers as that of some other sets of producers, has been sacrificed to it."

Again, in describing the essential features of the system of natural liberty the first sentence runs: "Every man, as long as he does not violate the laws of justice, is left perfectly free to pursue his own interest his own way." But it is plain, from the whole trend of the argument, in which the mercantile system is attacked that, in Adam Smith's opinion, the interests of the productive labourers had been sacrificed to the interests of monopolies,[2] and that the whole body of consumers had suffered by the reduction in the produce of the land and labour of the society consequent on these same monopolies.

§ 3. *Taxes on Consumable Commodities: Effect on Labour.*

The same ideas are evident in the treatment of the taxes on consumable commodities. A distinction is drawn between the taxes which are intended

[1] Book IV. chap. viii. The producers sacrificed are the poor spinners, the artisans, etc. See below Chapter X. § 4, pp. 141-4.

[2] See next chapter.

primarily for revenue and those the object of which is to secure the monopoly of the home market. "Taxes imposed with a view to prevent or even to diminish importation are evidently as destructive of the revenue of the customs as of the freedom of trade." A passage already quoted deserves requotation for emphasis at this point. "The greater part of the taxes have been imposed for the purpose not of revenue but of monopoly or to give our own merchants an advantage in the home market. By removing all prohibitions, and by subjecting all foreign manufactures to such moderate taxes as it was found from experience afforded from each article the greatest revenue to the public, our own workmen might still have a considerable advantage in the home market; and many articles, some of which at present afford no revenue to the government and others a very inconsiderable one, might afford a very great one." [1]

This passage is so liable to misquotation that it is well to point out that in the account which follows of the advantages of this proposed reform of the customs duties the phrase occurs, "taxation being always employed as an instrument of revenue and never of monopoly." It is often forgotten by those who imagine that Adam Smith advocated free importation under all conditions of all things, that one of his greatest contributions to practical finance was in the improvements he suggested in the customs duties considered as sources of revenue. His lead-

[1] Book v. chap. ii.

ing ideas were: that the number of such duties should be very greatly reduced; that the rate should be lowered so that the revenue might be increased by the extension of demand; and that the indirect expense should be diminished by more effective administration and by the provision of bonded warehouses. "If by such a change in system the public revenue suffered no loss the trade and manufactures of the country would gain a very considerable advantage. The trade in the commodities not taxed, by far the greatest number, would be perfectly free and might be carried on to and from all parts of the world with every possible advantage. Among those commodities would be comprehended all the necessaries of life, and all the materials of manufacture. . . . It must always be remembered, however, that it is the luxuries and not the necessary expense of the inferior ranks of the people that ought ever to be taxed."

§ 4. *Taxation of Necessaries: Reasons against.*[1]

And here it must be observed that Adam Smith did not insist on the exemption of necessaries simply on the ground of inequality of sacrifice and the burden on the poor of such taxes. He did not regard the question simply from the point of view of the consumer. On the contrary, he held that as regards the lowest classes of labour who lived very near the minimum of subsistence, any tax on necessaries must be transferred to the employers of labour,

[1] See also below, Chapter XI. § 10, p. 163.

and that any rise in the cost of the lowest sorts of labour must also indirectly raise the cost of the higher grades; so that taxes on necessaries in the end meant a general rise in the cost of labour in the country concerned. If, then, conversely, such taxes were taken off, there would be a reduction in the cost of labour. Money wages would be less (so far as dependent on the cost of necessaries),[1] but real wages indirectly would be raised. This argument is of historical importance, as it had great influence with the manufacturers who advocated the repeal of the corn laws. The benefit to the consumer *qua* consumer was an afterthought.

The point of importance in the present argument is that Adam Smith does not look on the reduction or abolition of customs duties only from the point of view of the consumer, but he always traces the effect on labour. The labourers, no doubt, gain as consumers, unless their money wages are reduced precisely in proportion to the fall in the articles freed from taxes. But money wages are not on balance reduced so much —they may not even fall at all—because there is an improvement in the demand for labour. The two sources of gain are well brought out in the summary of the advantages to be derived from a reduction in the national debt. "The people might be relieved from some of the most burdensome taxes; from those which are imposed either on the necessaries of life or upon the materials of manufacture. The labouring

[1] "The reduction in the money price of labour would necessarily be attended with a proportionable one in that of all home manufactures, which would thereby gain some advantage in all foreign markets" (Bk. v. ch. ii.).

poor would thus be enabled to live better, to work cheaper, and to send their goods cheaper to market. The cheapness of their goods would increase the demand for them, and consequently for the labour of those who produced them. The increase in the demand for labour would both increase the numbers and improve the circumstances of the labouring poor. Their consumption would increase, and together with it the revenue arising from all those articles of their consumption upon which the taxes might be allowed to remain."[1]

§ 5. *Mr. Gladstone on Cheapness and Employment.*

There is a famous passage in Mr. Gladstone's financial statement of 1860, in which he replies to the ultra-orthodox Free Traders who tried to show that the commercial treaty with France was an infringement of their dogma. The main point is a reassertion of Adam Smith's position on the employment of productive labour (p. 128). "It is a mistake to suppose that the best mode of giving benefit to the working classes is simply to operate on the articles consumed by them. If you want to do them the maximum of good you should operate on the articles which give them the maximum of employment."[2] He illustrates by reference to the Corn Laws. He says it is doubtful if the repeal up to that time had made bread cheaper; but the trade in corn had developed a corresponding export trade with a rise in wages, and it is "the enhanced price their labour thus brings even more

[1] Book v. chap. iii. [2] Gladstone's *Financial Statements*, p. 128.

than the cheapened price of commodities, that forms the main benefit they receive. That is the principle of a sound political economy applicable to commercial legislation."

§ 6. "*All Taxes on Commodities tend to reduce Employment.*"

One more sentence may be given from Adam Smith: "All taxes on consumable commodities tend to reduce the quantity of productive labour below what it otherwise would be, either in preparing the commodities taxed if they are home commodities, or in preparing those with which they are purchased if they are foreign commodities." Curiously enough, the illustration given of the last case is that of the hardware trade of Birmingham, and the producer who is adversely affected is not directly the common artisan but the manufacturer himself. "The dearer the Birmingham manufacturer pays for his foreign wine the cheaper he necessarily sells that part of his hardware with which, or what comes to the same thing, with the price of which he buys it. That part of his hardware, therefore, becomes of less value to him, and he has less encouragement to work at it." And then follows the general principle that is fundamental in all foreign trade: "The dearer the consumers in one country pay for the surplus produce of another, the cheaper they necessarily sell that part of their own surplus produce with which, or what comes to the same thing with the price of which, they buy it. That part of their own

surplus produce becomes of less value to them, and they have less encouragement to increase its quantity."[1]

§ 7. *The Masses of the People are the Masses of Consumers and Producers.*

In dealing with taxes on consumable commodities Adam Smith brings out very clearly the fundamental idea that the masses of the consumers are also the masses of the producers of the country. "The whole consumption of the inferior ranks of people or of those below the middling rank, it must be observed, is in every country much greater not only in quantity but in value than that of the middling and of those above the middling rank. The whole expense of the inferior is much greater than that of the superior ranks. In the first place, almost the whole capital of every country is annually distributed among the inferior ranks of people as the wages of productive labour." But apart from the wages of productive labour paid out of capital (or rather from the continuous reproduction of capital), a great part of the revenue that arises from the rent of land and the profits of stock is spent in the wages of servants and other unproductive labourers. And besides, the inferior ranks themselves own a certain amount of land and capital from which they receive revenue directly.

The actual statistics of consumption confirm this view. Production on a large scale means also con-

[1] Book v. chap. ii.

sumption on a large scale. When Adam Smith wrote he included under the foreign luxuries,—taxes on which fell principally upon the middling or superior ranks of the people,—coffee, chocolate, tea,[1] sugar, etc., which are all now regarded as necessaries.

The taxes which fall on articles of general consumption are always much more productive than those which fall on the luxuries consumed by the richer classes. It follows, then, that only a relatively small part of the total revenue of a country can be obtained from taxes on foreign imports that are luxuries in the sense that they do not enter into the general consumption of the masses of the people. And conversely if a large revenue is to be obtained from taxes on imports, such taxes must be imposed on things that directly or indirectly affect the consuming power of the masses of the people. But a reduction in the consuming power of the people is the same thing as a falling off in the aggregate annual produce of the land and labour of the country, and that again means that for a given amount of labour a less real reward is forthcoming.

§ 8. *Adam Smith always considers the Producer as well as the Consumer.*

There can be no question that Adam Smith always considered the effects of foreign trade not merely from the point of view of the consumer but also from that of the producer. Comparing his treatment with

[1] "Tea was a drug very little used in Europe before the middle of last century."—Book I. chap. xi.

that of his successors, it may be said, generally, that they lost sight of the importance of the employment of productive labour, and fixed the attention almost entirely on the importance of cheapness to the consumer. To begin with, the ultra-orthodox economists of the first half of the nineteenth century, in the interests of cheapness, overlooked the conditions of employment under which the cheapness was attained. Gradually, however, public opinion was aroused and the regulation of the conditions of labour was enforced by manifold legal enactments, and by the visitations of a multitude of inspectors.

In our own days public attention has been turned to the provision of remedies against unemployment of various kinds, and to the organisation of markets for labour. This consideration of the real interests of labour is only a reassertion and a development of the principles of Adam Smith. The experience of Australia, however, shows that this reaction may be carried too far, and that the interests of the consumer may be unduly neglected. The actual method adopted by Adam Smith was to look at the people of a nation as both consumers and producers. He was not content to look only to cheapness; he considered the reactions of cheapness on the employment and conditions of labour. And in the same way he was not content to look on the mere exclusion of foreign goods as necessarily involving an increase in the employment of home labour; he took account of the direct and indirect effects of the monopoly of the home market. The importance of cheapness to

"the great body of the people"—or the interest of the "consumer"—is perhaps most emphasised by Adam Smith in the chapter in which he attacks the mercantilist policy of imposing "extraordinary restraints on the importation of goods of almost all kinds from those countries with which the balance of trade is supposed to be unfavourable."[1]

The idea is still popular that we should give special advantages to those countries which take most of our exports, and Adam Smith did good service in showing that even on the principles of the mercantilist system—*i.e.* on the idea that the advantage of trade is to be measured by the excess of the money value of the exports over the imports—it is best for a country to buy in the cheapest and sell in the dearest market, regardless of the particular balances. The argument really makes the same assumption as in the modern pure theory, in which the rest of the commercial world is regarded, relatively to any one country as the "other country"—the theory being worked out on the hypothesis of two nations only trading together. It is quite clear that if the object is to have a favourable balance on the whole of the trade of any country, we must look to the aggregate of the exports and the imports.

But having disposed of the mercantilist fallacy, "even on their own principles," he goes on to show the unreasonableness of these restraints on other principles.[2]

[1] Book IV. chap. iii.

[2] Book IV. chap. iii. part ii.

It is in this part that are found the passages so often quoted which seem to support the simple dogmatic position that in foreign trade only the interests of the consumer need be regarded. "In every country it always is, and always must be, the interest of the great body of the people to buy whatever they want of those who sell it the cheapest. The proposition is so manifest that it seems ridiculous to take any pains to prove it; nor could it ever have been called in question had not the interested sophistry of merchants and manufacturers confounded the common sense of mankind. Their interest is in this respect directly opposite to that of the great body of the people. As it is the interest of the freemen of a corporation to hinder the rest of the inhabitants from employing any workmen but themselves, so it is the interest of the merchants of every country to secure to themselves the monopoly of the home market. Hence in Great Britain and in most other European countries the extraordinary duties upon almost all goods imported by alien merchants. Hence the high duties and prohibitions upon all those foreign manufactures which can come into competition with our own. Hence, too, the extraordinary restraints upon the importation of almost all sorts of goods from those countries with which the balance of trade is supposed to be unfavourable; that is, from those against whom national animosity happens to be most violently inflamed."

Adam Smith, in this place, also introduces his leading principle that a nation which would enrich

itself with foreign trade is certainly most likely to do so when its neighbours are all rich, industrious, and commercial nations. "The wealth of neighbouring nations, though dangerous in war and politics, is certainly advantageous in trade." The richer the neighbours the richer the state: the gain of one nation is not the loss of another, but all trade is of advantage to both parties (though the advantage may not be equal).

There can be no doubt, both from the passages cited and from the context, that here as throughout his work Adam Smith is attacking monopoly and monopolists; "the mean rapacity, the monopolising spirit of merchants and manufacturers who neither are nor ought to be the rulers of mankind." Here, as elsewhere, the consumer is identified with the great body of the people, and from this point of view the interest of the monopolist is opposite to the interest of the public.

"The interest of the dealers in any particular branch of trade or manufactures, is always in some respects different from, and even opposite to, that of the public. To widen the market, and to narrow the competition, is always the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public; but to narrow the competition must always be against it, and can only serve to enable the dealers, by raising their profits above what they naturally would be, to levy, for their own benefit, an absurd tax upon the rest of their fellow-citizens. The proposal of any new law or regulation of commerce which comes from this

order, ought always to be listened to with great precaution, and ought never to be adopted till after having been long and carefully examined not only with the most scrupulous, but with the most suspicious attention."[1]

When the interest of the consumer (*i.e.* of the masses of the people) in cheapness is weighed against the interest of the monopolist in artificial dearness it is quite clear that "those who first taught it [*i.e.* the mercantilist doctrine of monopoly] were by no means such fools as they who believed it."

In spite, however, of the vigour of the rhetoric and of the apparent simplicity of the principles laid down it would be a great error to suppose that the passages quoted can be taken as giving a fair summary of the teaching of the *Wealth of Nations* on the national policy that ought to govern foreign trade.

The question must be regarded not only from the point of view of the "consumer" but from that of the "producer." And if the "consumer" is interpreted to mean the "great body of the people" the "producer" also must bear the same interpretation; the great body of the people, as is now evident from the reports of the census, is occupied in various forms of "production"; and for the most part in order to consume, a man must first produce something to sell, just as in the simplest barbarism, as a rule, in order to eat, a man must toil.

It would be quite easy to quote from Adam Smith passages equally emphatic on the superior advantage

[1] This passage is part of the general conclusion of Book I.

to labour of home over foreign trade, and of the differences in advantage of various kinds of foreign trade. Indeed, such passages have already been cited; to neglect them is to overlook at least half of the fundamental principles of the *Wealth of Nations* and considerably more than half of the difficulties. Those who rely only on the argument from cheapness to the consumer are met by arguments from Adam Smith himself, stated with equal vigour, on the advantage of the employment of home labour—and Adam Smith the free trader is confronted by Adam Smith the protectionist. Obviously one of the Adam Smiths must be silenced or the two must be reconciled. The real Adam Smith flattered himself he had effected a reconciliation; he did not feel the discomfort of struggling contradictions. He set himself to prove by an elaborate investigation that the various forms of protection to labour were either useless or hurtful; the great body of the people gained on his view not only as consumers but as producers from the freedom of trade. But as already shown this latter position (and though to a less extent the former also) needs the verification of experience, and from generation to generation experience changes or may change. What we have to show is that in our day, as Adam Smith showed was the case in his day under freedom of trade, the productive powers of the nation (not of the world) will be used to the greatest advantage; that as great a quantity of capital as possible will be employed within the country; that the land will be used to the best advantage; and that the various

forms of labour will be employed in the best manner from the national point of view. And we have to consider also what is the effect on our arguments if for the nation we substitute the empire. In this demonstration no repetition of postulates and axioms can dispense with the appeal to experience.

The monopoly of the home market is only possible through a number of restraints and restrictions imposed by the state. And before an opinion can be formed of the general advantages of intervention, account must be taken of difficulties involved. These difficulties may be summarised under the expression the negative argument for freedom—the subject of the next chapter.

§ 9. *Peel and Cobden on Consumers and Producers.*

Before proceeding to this topic, the general argument of this present chapter that the interests of both consumers and producers must be considered, may be enforced and illustrated by reference to the two statesmen who had the greatest influence in Parliament and in the country in carrying the repeal of the Corn Laws, namely, Sir Robert Peel and Richard Cobden. The fact that had most influence with Peel was the discovery that for a very long period the agricultural labourer was interested in the price of corn not as a producer but as a consumer.[1] Peel was a model landlord — his yearly tenants refused to accept leases — most interested in the conditions of the people on his estate. Cobden, on

[1] See *History of the English Corn Laws*, by the present writer, p. 101.

the other hand, said of Peel that he took "the least comprehensive and statesmanlike view of his measures when he proposed to lower prices instead of aiming to maintain them by enlarging the circle of exchange."[1]

[1] Morley's *Life of Cobden*, vol. i. p. 322.

CHAPTER X

THE NEGATIVE ARGUMENT FOR FREEDOM OF TRADE

§ 1. *Sidgwick's Critique of Popular Ideas on Free Trade and Protection.*

THE subject of this chapter may be introduced by a passage from Henry Sidgwick, who could divide a hair between south and south-west side with greater nicety than any Greek sophist or mediæval casuist In his chapter on Protection[1] he states that "the ordinary moderate view on the subject—held by practical persons who wish to avoid both extremes —is a curious perversion of the truth, at least on the practical issue most commonly raised. The moderate view is that all protection is theoretically wrong, so far as purely economic considerations are concerned; but that practically a little protection here and there does more good than harm to industry, owing to influences which abstract theory overlooks. I hold, on the contrary, that when the matter is considered from the point of view of abstract theory it is easy to show that protection, under certain not improbable circumstances, would yield a direct economic gain to the protecting country: but that from the

[1] *Principles of Political Economy*, Book III. chap. v.

difficulty of securing, in any actual government, sufficient wisdom, strength, and singleness of aim to introduce protection only so far as it is advantageous to the community and withdraw it inexorably so soon as the public interests require its withdrawal, it is practically best for a statesman to adhere to the broad and simple rule of 'Taxation for revenue only,'—at any rate in a free community where habits of commercial enterprise are fully developed."

§ 2. *Adam Smith on Statesmen and their Advisers.*

It is clear from the importance assigned by Adam Smith to the employment of labour and capital in the home country that he, at any rate, cannot proceed at once from the cosmopolitan to the national point of view. More than any other economist, he recognised the supreme importance of national interests; and the exceptions to freedom of importation which he explicitly admits may be easily extended to cover a number of theoretical cases.[1]

But before putting theory to practice he took account of the elements conveniently summarised under the modern expression, the negative argument for freedom. Influenced by the appeal to experience he distrusted the wisdom, the strength, and the singlemindedness of the statesman, and still more he distrusted the guidance of those who advised the statesman in matters in which they themselves were interested. His attitude will be at once clear from the following significant passages, some of them

[1] See below, Chapter XI.

familiar from frequent quotation, but essential to the understanding of his general position. "I have never known much good done by those who affected to trade for the public good. It is an affectation indeed not very common among merchants, and very few words need be employed in dissuading them from it." . . . "The statesman who should attempt to direct private people in what manner they ought to employ their capitals would not only load himself with a most unnecessary attention, but assume an authority which could safely be trusted not to no single person but to no council or senate whatever, and which would nowhere be so dangerous as in the hands of a man who had folly and presumption enough to fancy himself fit to exercise it." . . . "To judge whether such retaliations are likely to produce such an effect does not perhaps belong so much to the science of the legislator whose deliberations ought to be governed by general principles which are always the same, as to that insidious and crafty animal vulgarly called a statesman or politician, whose councils are directed by the momentary fluctuations of affairs."

But if Adam Smith distrusted the wisdom and powers of statesmen he distrusted still more their advisers. "That foreign trade enriched the country, experience demonstrated to the nobles and country gentlemen, as well as to the merchants; but how or in what manner none of them well knew. The merchants knew perfectly in what manner it enriched themselves. It was their business to know it. But

to know in what manner it enriched the country was no part of their business. This subject never came into their consideration but when they had occasion to apply to their country for some change in the laws relating to foreign trade. It then became necessary to say something about the beneficial effects of foreign trade, and the manner in which those effects were obstructed by the laws as they then stood." In this connection the remark of Dr. Johnson may be recalled, who replied when some one asserted that Adam Smith was not qualified to write about trade because he had never been in trade: "He is mistaken, sir, there is nothing which requires more to be illustrated by philosophy than trade does."

§ 3. *The Evils of Monopoly.*

It must not be supposed that Adam Smith's severe strictures on the merchants and manufacturers were called forth simply as a rhetorical support of the system of natural liberty. His attitude is explained in the first place by reference to underlying economic principles. Individuals naturally seek to attain the best profit on their capital; but for this purpose a combination or monopoly will often be more effective than competition. On the whole, however, the public interest is promoted by competition and injured by monopoly. Profit realised under natural conditions, that is to say, without the aid of monopoly, Adam Smith thinks is, in general, conducive to the national advantage; but as soon as monopoly enters in, the nation suffers for the benefit of a class.

The centre of his attack on the old mercantile system is that it was based on monopoly. "Monopoly of one kind or another seems to be the sole engine of the mercantile system." . . . "Merchants and manufacturers are the people who derive the greatest advantage from this monopoly of the home market." . . . "Country gentlemen and farmers are, to their great honour, of all people the least subject to this wretched spirit of monopoly." The following passage shows the wide application made of this fundamental difference. "The superiority which the industry of the towns has everywhere in Europe over that of the country is not altogether owing to corporations and corporation laws.[1] It is supported by many other regulations. The high duties upon foreign manufactures and upon all goods imported by alien merchants all tend to the same purpose. Corporation laws enable the inhabitants of the towns to raise their prices without fear to be undersold by the free competition of their own countrymen. Those other regulations secure them equally against that of foreigners. The enhancement of price occasioned by both is everywhere finally paid by the landlords, farmers, and labourers of the country who have seldom opposed the establishment of such monopolies. They have commonly neither inclination nor fitness to enter into combinations; and the clamour and sophistry of merchants and manufacturers easily persuade them that the private interest of a part, and

[1] The reference is to the exclusive regulations adopted by the mediæval towns to protect their own burgesses.

of a subordinate part of the society, is the general interest of the whole." [1]

As already indicated, and as will be shown in detail later on, Adam Smith was not only a national but an imperial economist, and the centre of this attack on the imperial policy of the mercantilists was that it was based on monopoly. Alike in the British colonies of North America and in India, the mercantile policy failed to realise the larger issues of empire; and in both cases the reason is the same; the policy was actuated by the narrow spirit of trade monopoly. "Monopoly is the great engine of both; but it is a different sort of monopoly."

Examples might be multiplied from the *Wealth of Nations* to show that in every part of the economic system, with few exceptions, monopolies were detrimental to the public interest. If their growth cannot be prevented then they should be mulcted of their gains—"the gains of monopolists, whenever they can be come at, being of all subjects of taxation the most proper." [2]

§ 4. *Monopoly and the Interests of Labour.*

The chapter entitled "The Conclusion of the Mercantile System" (Bk. IV. ch. viii.)[3] gives a good illustration of the way in which the monopoly of the home market was managed merely for profit and not for the increased employment of home labour. To begin with, Adam Smith points out that the raw materials

[1] Book I. chap. x. part ii. [2] Book V. chap. ii. part ii. art. iv.

[3] This chapter was added by Adam Smith to the last edition revised by him (the third in 1784). See Dr. Cannan's edition, Introduction, p. xv.

of manufacture were in many important cases admitted free; and although these exemptions "may have been extorted from the legislature by the private interests of our merchants and manufacturers they are perfectly just and reasonable; and if, consistently with the necessities of the State, they could be extended to all the other materials of manufacture, the public would certainly be a gainer." So far, this is a position which has been generally adopted both in theory and in practice. But the particular example which follows is of the nature of a crucial instance. "The avidity of our great manufacturers, however, has in some cases extended these exemptions a good deal beyond what can justly be considered as the rude materials of their work." The case examined at length is that of linen yarn. At one time this importation had been subject to a high duty, but finally even the surviving small duty of one penny per pound had been repealed. And on this repeal Adam Smith has some very remarkable comments, —remarkable that is to say, in view of the common opinion of his system. "In the different operations which are necessary for the preparation of linen yarn a good deal more industry is employed than in the subsequent operation of preparing linen cloth from linen yarn. To say nothing of the industry of the flaxgrowers and flaxdressers, three or four spinners at least are necessary in order to keep one weaver in constant employment; and more than four-fifths of the whole quantity of labour necessary for the preparation of linen cloth is employed in that of

linen yarn; but our spinners are poor people, women commonly scattered about in all different parts of the country, without support or protection. It is not by the sale of their work, but by that of the complete work of the weavers that our great master manufacturers make their profits. As it is their interest to sell the complete manufacture as dear, so it is to buy the materials as cheap, as possible. By extorting from the legislature bounties on the exportation of their own linen, high duties on the importation of all foreign linen, and a total prohibition of the home consumption of some sorts of French linen, they endeavour to sell their own goods as dear as possible. They are as intent to keep down the wages of their own weavers as the earnings of the poor spinners; and it is by no means for the benefit of the workmen that they endeavour either to raise the price of the complete work or to lower that of the rude materials. It is the industry that is carried on for the benefit of the rich and powerful that is principally encouraged by our mercantile system. That which is carried on for the benefit of the poor and indigent is too often either neglected or oppressed."[1] It is quite clear from this passage that Adam Smith did not approve of the repeal of the duty on linen yarn, the reason being that the duty so far gave encouragement to the home labour of flaxgrowers and spinners. It is implied that the advantage to the nation is measured by the relative amount of the home labour employed.

[1] The application of the ideas to the case of "sweated industries" is obvious.

It is also clear that he considered that the duty was repealed solely in the interests of the profit of the manufacturers of linen cloth who sought to strengthen their monopoly.

§ 5. *Protection to Agriculture not based on Monopoly*

The negative argument, however, does not depend entirely on the weakness of statesmen, or the self-seeking of their advisers, the traders of all kinds. In the case which from his point of view is by far the most important, namely, that of agriculture, he does not think the landed interests were actuated by the spirit of monopoly. It is noteworthy, in view of the popular sentiment which was aroused by the agitation which led to the repeal of the corn laws, that Adam Smith did not originate nor even share this distrust of the landlord. He generally brackets the country gentlemen, the farmers, and the labourers together, in the consideration of the agricultural interests as compared with those of the towns. It is true that he entirely disapproves of the various artificial devices by which large estates were created and perpetuated —the system of land laws, he maintained, ought to be reformed altogether; but he did not hold the view that the owners of land possessed and exploited a monopoly. "Country gentlemen and farmers, dispersed in different parts of the country, cannot so easily combine as merchants and manufacturers who being collected into towns, and accustomed to that exclusive corporation spirit which prevails in them,

naturally endeavour to obtain against all their countrymen the same exclusive privilege which they generally possess against the inhabitants of their respective towns. They accordingly seem to have been the original inventors of those restraints upon the importation of foreign goods which secure to them the monopoly of the home market. It was probably in imitation of them, and to put themselves on a level with those who they found were disposed to oppress them, that the country gentlemen and farmers of Great Britain so far forgot the generosity which is common to their station as to demand the exclusive privilege of supplying their countrymen with corn and butcher's meat. They did not, perhaps, take time to consider how much less their interest could be affected by the freedom of trade than that of the people whose example they followed."[1]

§ 6. —*and unnecessary on Account of Natural Conditions.*

With regard to agriculture Adam Smith relies mainly on the idea that the industry is sufficiently protected and encouraged by natural conditions. Not only, as already shown, do people prefer to employ their capital in that way, even at a lower profit, but the cost of transport, as compared with that of the finer manufactures in particular, affords a natural protection against foreign competition. After stating that if manufactures were freely admitted some home manufactures might suffer greatly or even be ruined

[1] Book IV. chap. ii.

he proceeds: "But the freest importation of the rude produce of the soil could have no such effect upon the agriculture of the country." It is not necessary to go into the details of the argument in which he takes separately the importation of live cattle—both fat and lean—of salted provisions, and of grain. It is sufficient to say that the argument remained essentially valid until a hundred years after it was advanced (1776-1876), including the period of thirty years from the repeal of the Corn Laws (1846-1876). And as regards this repeal it must be remembered that the strongest advocates of the repeal relied largely on this argument of natural protection. They supposed that for the most part every country must depend in the main on its own agricultural resources, and at any rate that these resources must be utilised to the full before foreign competition could be effective. The importation of foreign food supplies was regarded as supplementary to the home supplies and not as displacing such supplies.[1] Adam Smith was able to write: "Even the freest importation of foreign corn could very little affect the interest of the farmers of Great Britain. Corn is a much more bulky commodity than butcher's meat. A pound of wheat at a penny is as dear as a pound of butcher's meat at fourpence. The small quantity of foreign corn imported even in times of the greatest scarcity may satisfy our farmers that they can have nothing to fear from the freest importation."[2]

[1] Cf. *The History of the English Corn Laws*, by the present writer, p. 160.
[2] Book IV. chap. ii.

But though this argument remained essentially true in fact for a hundred years, during the last generation the reduction of the cost of freights on the one side, and on the other the exploitation regardless of the waste[1] of natural fertility of the soils of new countries have brought about a fundamental change in the conditions. It is quite obvious that, at any rate, this part of the negative argument on which Adam Smith laid such stress is no longer applicable.

§ 7. *Import of Food necessary with Growth of Population.*

As already observed, Adam Smith not only appealed to actual experience, both past and present, but he was bold enough to take long views into the future. And although he thought the British farmer could never be injured by natural free importation, he seems to have anticipated a time when the growth of population in this country would depend on the possibility of obtaining food supplies from abroad. "To prohibit by a perpetual law the importation of foreign corn and cattle is in reality to enact that the population and industry of the country shall at no time exceed what the rude produce of its own soil can maintain."

In effect the surplus population of this country

[1] "In spite of the marvellous growth of American agriculture and its apparent prosperity it is doubtful if it has ever been self-supporting in any strict sense before the present period. The average farmer had never counted the partial exhaustion of the soil as part of the cost of a crop. Taking the country over it is probable that if the farmers had been compelled to buy fertilizers to maintain the fertility of their soil without depletion, the whole industry would have become bankrupt."—T. N. Carver, *Historical Sketch of American Agriculture.*

must in the end be fed by the surplus food products of other countries.

§ 8. *Failure of Protection to prevent Rural Depopulation.*

The history of the English Corn Laws[1] is full of examples of the negative argument for freedom. The laws affecting imports were ostensibly designed not for revenue but for protection.

And yet so far as rural labour was concerned they failed to keep up the numbers of labourers engaged in agriculture. "In spite of the high protective duties, the proportion in Great Britain of families engaged in agriculture declined from 35·2 per cent in 1811 to 25·9 per cent in 1841 of the total number of families. Between 1821 and 1831 there was an absolute decrease in the number of families in agriculture in spite of an increase of about 19 per cent in the aggregate number of families in Great Britain. . . . If we compare 1831 with 1841, with an absolute increase in population of over two millions, there was an absolute decrease in the number of adult males employed in agriculture."[2]

§ 9. *Other Means of encouraging Agriculture.*

In the last chapter of his fourth book, Adam Smith deals with the Agricultural System of Political Economy which had been expounded by the French economists with whom he had on the whole great

[1] Cf. *Hist.*, *op. cit.* pp. 111, 118.
[2] Porter's *Progress of the Nation*, pp. 61, 62.

sympathy. So complete, indeed, is the harmony of views as regards the system of natural liberty in general, that until Dr. Cannan published the notes of the original lectures given by Adam Smith at Glasgow, it was generally supposed that he had derived some of his leading ideas from actual conversations with Quesnay and others during his visit to France.

But in spite of his insistence on the fundamental national importance of agriculture, and his partial acceptance of the idea of a net product arising in agriculture over and above the ordinary profits of industry, Adam Smith comes to the conclusion that it is not desirable to attempt artificially to encourage agriculture. "Those systems, therefore, which, preferring agriculture to all other employments in order to promote it, impose restraints on manufactures and foreign trade, act contrary to the very end which they propose, and indirectly discourage that very species of industry which they mean to promote."

It may be recalled, also, that Adam Smith strongly condemned the bounty on the export of corn, although it was expressly designed to encourage agriculture. It is unnecessary to examine at this place either of these arguments; it is enough to note that in spite of what are generally considered extravagant eulogies of the employment of capital in agriculture, even in this case Adam Smith does not suppose that the encouragement of the state would have the results anticipated. And it is not because he is led away by doctrinaire prejudices against the interference of the

state; for he admits very large exceptions to the general policy of *laisser faire*, and the principles at the basis of these exceptions are capable of much wider extension under modern conditions.[1]

Adam Smith sought for the real encouragement to agriculture in freeing land from the restraints of antiquated laws and customs, improving facilities for transfer and increasing the security for the investment of capital—ideas which have been the leading principles of all the reforms of laws affecting agriculture since his time.

§ 10. *Present Importance of the Negative Argument.*

The negative argument for free trade demands special emphasis at the present time. When Adam Smith wrote, and for seventy years afterwards, the people of this country had before their eyes living examples of the difficulties of putting into practice such theories, for example, as the encouragement to native industry by a mass of protective duties; the effective use of retaliation; the adjustment of reciprocity treaties; the preferential treatment of colonies and other devices of state control. The advocates of free trade could point to the actual inconveniences and imperfections of state interference. The famous report of 1842, on which was based the budget of that year, is in its way as remarkable a document as the report of the poor law commission of 1834. If in either case, owing to change in conditions, we have again to modify the legislation

[1] See next chapter.

founded on these reports we ought at any rate to take good care that with new reforms we do not resuscitate old evils. In both cases the fundamental difficulty was unemployment. The old poor law broke down because, with the best of intentions in the desire to cure unemployment, it aggravated the disorder; in the same way the old protective system, with the laudable idea of giving encouragement to the labour of the country checked the expansion of industry and lowered real wages. Every one who has studied the subject is agreed that such was the result of the "bad old system"; no practical statesman would dream of proposing to return to such a system, any more than he would propose to restore the old allowance system and other devices of the old poor law.

The negative argument for free trade founded on history and experience reveals three main dangers in the opposite system. First, there is the danger, so constantly appealed to by Adam Smith, of giving the monopoly of the home market to particular traders against their own countrymen. We think the trusts are wholly modern; that monopoly is the result of modern conditions summarised under the law of increasing return. In fact, as Adam Smith showed, the whole mercantile system was permeated through and through with monopoly. In any departure from free trade we must guard against the recurrence of monopoly. Secondly, there is the danger that though we visibly encourage one or more industries we may impose greater restraints on the whole industry of the country; that the aggregate value of

the annual produce of the land and labour of the country, including what is got in exchange, may become less; and the consuming power of the masses of the people be diminished. And thirdly, there is the danger of losing the advantages of reciprocity or of the most favoured nation clause by the complications introduced through a network of commercial treaties, and attempts at retaliation.

But although the negative argument must be fully considered, it does not follow that under no circumstances is the state to interfere with the natural course of foreign trade. Adam Smith himself admitted exceptions to free trade which are of the greatest range and importance. An examination of these exceptions will throw light both on the negative and the positive arguments for free trade. (See Chapter XI.)

CHAPTER XI

ADAM SMITH'S EXCEPTIONS TO FREE TRADE

§ 1. *Meaning of "Exceptions to Free Trade."*[1]

THE term "Free Trade," as already observed, is sometimes taken in a wide sense as equivalent to the system of natural liberty in general;[2] but in political controversy, if we look to actual history, the term has a much more restricted meaning. It is used specially in reference to foreign trade, and means the absence of differential duties (or bounties) in favour of the home products; it is in this restricted sense that Adam Smith's exceptions to free trade are examined.

"There seem, however, to be two cases in which it will generally be advantageous to lay some burden upon foreign for the encouragement of domestic industry."

§ 2. *First Exception: if the Industry is necessary for Defence; the Navigation Act.*

"The first is when some particular sort of industry is necessary for the defence of the country. The defence of Great Britain, for example, depends very

[1] Book IV. chap. ii.

[2] The general relations of the State to commerce are discussed in the next chapter.

much upon the numbers of its sailors and shipping. The Act of Navigation, therefore, very properly endeavours to give the sailors and shipping of Great Britain the monopoly of the trade of their own country, in some cases by absolute prohibition, and in others by heavy burdens upon the shipping of foreign countries."

Then follows the detailed account of the provisions of the Act of Navigation (1660), and the well-known eulogy already quoted on the political ideas on which it was based.

"It is not impossible that some of the regulations of this most famous Act may have proceeded from national animosity. They are as wise, however, as if they had all been dictated by the most deliberate wisdom. National animosity at that particular time aimed at the very same object, which the most deliberate wisdom would have recommended, the diminution of the naval power of Holland, the only naval power which could endanger the security of England." On other grounds it was condemned:

"The Act of Navigation is not favourable to foreign commerce, or to the growth of that opulence which can arise from it. The interests of a nation in its commercial relations to foreign nations is like that of a merchant with regard to the different people with whom he deals, to buy as cheap and to sell as dear as possible. But it will be most likely to buy cheap, when by the most perfect freedom of trade it encourages all nations to bring to it the goods which it has occasion to purchase; and for the same reason

it will be most likely to sell dear when its markets are thus filled with the greatest number of buyers. The Act of Navigation, it is true, lays no burden on foreign ships that come to export the produce of British industry. Even the ancient aliens duty, which used to be paid upon all goods exported as well as imported, has by several subsequent acts been taken off the greater part of the articles of exportation. But if foreigners, either by prohibitions or high duties are hindered from coming to sell, they cannot always afford to come to buy; because, coming without a cargo, they must lose the freight from their own country to Great Britain. By diminishing the number of sellers, therefore, we necessarily diminish that of buyers, and are thus likely not only to buy foreign goods dearer, but to sell our own cheaper than if there was a more perfect freedom of trade. As defence, however, is of much more importance than opulence, the Act of Navigation is, perhaps, the wisest of all the commercial regulations of England."

Attempts have often been made in the interests of popular ideas of unrestricted free trade to take away from the significance of this passage. But the meaning is absolutely clear, both in general principles and particular instances. The passage gives one of the best statements of the general rule in favour of freedom, and thereby makes all the more forcible the exception.

The particular reference to the aliens duty is of interest at the present time when the payment of market dues is sometimes advanced as the rationale of

general import duties. The export duties had been already abandoned to a great extent, and the general import duties were finally abandoned by Gladstone on economic grounds, which ought to be studied before the system is reintroduced.[1]

Adam Smith's opinion on the Navigation Act, instead of being inconsistent with his general teaching, is in complete harmony with it, as will appear in dealing with his views on national defence and imperial federation.[2]

It is in the assertion of the subordinate importance of opulence to defence that the real value of the whole argument on this exceptional case is to be found. If the exception is to be applied in our own times, it ought to be applied not in the letter but in the spirit; and before we seek to apply it at all, we ought to take account of the practical difficulties and of the cost; and not only of the money or commercial cost, but of the cost to the nation in weakening other elements of national strength.

It is remarkable that this very exception, which is so strongly approved of by Adam Smith on principle, affords one of the best examples of the negative argument for free trade.

§ 3. *Effects of the Navigation Act.*

The better opinion of the author of the standard work on economic history, namely, Dr. Cunningham,

[1] In 1860 Gladstone imposed a duty of one penny per package on all goods exported or imported. It was at first estimated to yield £300,000 per annum. His reasons in support are given in *Financial Statements*, pp. 160, 161. His reasons for the repeal in 1863 are given on p. 372.

[2] See Chapter XIV.

who, as it happens, is to be classed as sympathetic with the proposed modification of our present system of freedom from differential duties, is that as a matter of history this famous Act failed in its purpose. An interesting detail may be quoted from Dr. Cunningham. Commenting on the effects of the Act of 1660, he writes:[1] "Indeed, in one branch of trade the measure recoiled upon its authors; the English had not a sufficient supply of ships of such burden that they could be employed in the Baltic and Scandinavian trade; and the restrictions imposed on them forced English merchants to abandon this line of commerce altogether. As a consequence, the Dutch obtained a more complete monopoly than before in the Baltic trade, which was the very foundation of their maritime power, and they could afford to relinquish the plantation trade which was at that time a somewhat small affair. On the whole, it seems that the Dutch did not suffer perceptibly during the seventeenth century." It is true that Dr. Cunningham also points out that English shipping developed enormously during the latter half of the seventeenth century, and "it is of course possible that the Navigation Act contributed along with other causes to this result . . . , but there is no sufficient proof of any direct connection between this celebrated measure and the decline of Holland." It is worth noting that incidentally the decline of Holland is largely attributed to the fact that its wealth depended so much on mere trade as distinct from industry, and thus

[1] Vol. ii. p. 212.

affords support to another of Adam Smith's favourite positions.[1]

It is also remarkable that the first part of the old mercantile system to be seriously attacked and modified by British statesmen was this famous Navigation Act, (under Huskisson from 1821 to 1825). Commenting on the final repeal (1854) Dr. Cunningham writes: "It is impossible to say how much of the increased prosperity which has attended British shipping is due to a change of policy, and how much to the application of engineering skill in giving increased facilities for ocean traffic, but the expansion of foreign trade in the twenty years which followed the repeal of the Navigation Laws was unprecedented. The total imports and exports of British and foreign produce almost trebled, and English shipping interest shook off for a time their anxiety as to being outdone by their competitors in the United States."[2]

It may also be pointed out, as shown by Adam Smith himself in another place, that with the progress of society war becomes more and more expensive,[3] and accordingly opulence must itself be considered as one of the chief bulwarks of defence. It is quite possible and, indeed, very probable that the increase of national wealth due to the repeal of the navigation acts may have more than compensated any political loss, either in the way of injury inflicted on our enemies, or in the encouragement given to our own shipping.

[1] Cf. p. 48. On the effect of the Navigation Act on the British colonies, see two admirable essays on "England and America" and "American Smuggling," by Professor Ashley in *Economic Surveys*, pp. 310-360.

[2] Vol. ii. part ii. p. 833.

[3] See below, Chapter XVI.

§ 4. *Adam Smith approves of Bounties for Defence.*

It is worth recalling the fact that although, in general, Adam Smith attacked the system of bounties more severely than any other part of the mercantile system he approved of bounties[1] on the export of British-made sailcloth and gunpowder, because in this way these industries would be encouraged; he considered that the nation ought not to rely on foreign sources of supply for such important elements of national defence; better apparently for our enemies to rely on us.

§ 5. *Extension of the Principle of Defence.*

The present writer is not concerned with Adam Smith's work except in so far as the ideas are applicable to actual problems. From this point of view, whether or not the Navigation Act was a success is a matter only of historical interest (except so far as furnishing the negative argument for free trade with striking examples); whilst on the other hand the ideas by which Adam Smith justified the policy are of supreme importance at the present time. Pursued to its logical issue Adam Smith's argument leads to the general conclusion that the whole commercial policy of the nation ought to be framed in such a way as to make the defence of the nation abundantly secure. It may be that on the whole it can be shown

[1] Book IV. chap. v.: "If any particular manufacture was necessary, indeed, for the defence of the society it might not always be prudent to depend upon our neighbours for the supply."

that the increase of opulence is the surest safeguard, and that the surest way to the increase of opulence is by unrestricted trade with foreign countries. But the moral of Adam Smith's treatment is that we cannot take it for granted that this simple easy method is also the best for our purpose. To take a living example, the protection afforded by Germany to agriculture is partly justified at any rate on the ground of imperial defence; and it is at least theoretically possible that in the interests of defence the British Empire may find it expedient to interfere with the natural course of trade, although it may not be by protection to agriculture any more than by bounties on the export of sailcloth and gunpowder.

§ 6. *Second Exception: Import duties to Balance Taxes on Home Products.*

"The second case in which it will generally be advantageous to lay some burden upon foreign for the encouragement of domestic industry is when some tax is imposed at home upon the produce of the latter. In this case it seems reasonable that an equal tax should be imposed upon the like produce of the former. This would not give the monopoly of the home market to domestic industry; nor turn towards a particular employment a greater share of the stock and labour of the country than what would naturally go to it. It would only hinder any part of what would naturally go to it from being turned away by the tax into a less natural direction, and would leave the competition between foreign

and domestic industry after the tax as nearly as possible upon the same footing as before it."

This second exception to free trade (or free imports) seems not only a natural corollary of the general argument on free trade, but also to be in harmony with common-sense ideas of natural justice. To act otherwise would be to give a bounty to foreign industry and to discourage home labour. In practice the most narrow of popular free traders would admit that to every excise duty there ought to be a corresponding customs duty. The difficulty is as usual not in the acceptance of the principle but in the carrying it out in particular cases.

§ 7. *Import Duties if much heavier lead to Monopoly.*

There is, first of all, the danger pointed out by Adam Smith: "In Great Britain, when any such tax is laid upon the produce of domestic industry, it is usual at the same time, in order to stop the clamorous complaints of our merchants and manufacturers that they will be undersold at home, to lay a much heavier duty upon the importation of all foreign goods of the same kind." Whether or not such differential treatment is or is not desirable may be a matter for discussion, but it would certainly not be in accordance with the general principle of free trade, of which a full examination from the point of view of Adam Smith has already been given. If a "much heavier" customs duty is imposed it will give the home producer a monopoly of the home market. It will be

noticed that as before Adam Smith deals with the case of high duties. But this is not the only difficulty.

§ 8. *Meaning of "Goods of same Kind."*

What is exactly meant by goods of the same kind? If the words are taken literally the application of the principle would be so curtailed as to be of little practical importance. The trade between nations does not consist of an exchange of identical commodities. Such an exchange would be absurd as a general rule; the great trades of the world are naturally in different kinds of things. But very different things may satisfy what are for practical purposes the same wants of consumers. One great difficulty in making taxes on commodities productive is that it is necessary to tax all possible substitutes.

§ 9. *Taxation of possible Substitutes.*

If the substitutes are not taxed the consumer will abandon the use of the taxed commodities.

The same principle ought to be applied in the case of the imposition of equivalent customs duties which are meant to balance the excises of the home country. Logically, the foreign substitutes ought to be taxed. Taxes on British beer and whisky, for example, are not fairly balanced by taxes on imported foreign beer and whisky, which would probably be negligible in quantity. Obviously the corresponding foreign substitutes are wines, brandies (and now potato spirit), etc. but then the difficulty arises what is to be the test of equivalence?

It is quite clear that the principle of substitution admits of very wide extension, as Adam Smith himself observes.

§ 10. *Proposed Extension of the Principle to all Home Taxes.*

"This second limitation of the freedom of trade, according to some people, should upon most occasions be extended much farther than to the precise foreign commodities, which could come into competition with those which had been taxed at home."

The case that he gives by way of illustration is the taxation of necessaries in the home country by which the general cost of labour is raised. At the time there were excises on various necessaries, such as salt, soap, candles, leather, etc. Adam Smith is of opinion (as shown[1] in his treatment of taxation) that such taxes do increase the cost of labour in the home country. But he objects to the extension of the method of countervailing duties of a general character on all foreign imports, so as to balance this increased cost of production on two grounds: first, that the effect cannot be exactly known as in the case of a particular tax; and secondly because the remedy proposed would probably only aggravate the disorder. Taxes on necessaries, he says, "when they have grown up to a certain height are a curse equal to the barrenness of the earth and the inclemency of the heavens, and yet it is in the richest and most industrious countries that they have been most

[1] See above, Chapter X.

generally imposed. No other countries could support so great a disorder. To lay a new tax upon them, because they are already over-burdened with taxes, and because they already pay too dear for the necessaries of life; to make them likewise pay too dear for the greater part of other commodities is certainly a most absurd way of making amends."

§ 11. *Difficulties of such Extension.*

At the present time it is often maintained that the system of taxation in any country (national as well as local) must be taken account of as an element in the cost of production of all commodities.[1] And then it is argued that to put the home producer on a fair footing all foreign imports ought to be taxed. This case is the same in substance as that noted by Adam Smith, and may be met by the same arguments. The first of these as to the precise scale of equivalence brings to the surface a difficulty that is presented by every system of general protection, the difficulty, namely, of an equitable adjustment of a complex system of differential duties. It is properly considered under the negative argument for free trade.

The second of Adam Smith's objections to the proposed general countervailing system involves the theory of the incidence of taxation. The popular opinion which he is attacking really assumes that the taxes on the foreign imports fall on the foreign producer; and Adam Smith, on the other hand, really assumes that the taxes fall on the home consumer.

[1] See below, Chapter XVI. § 10.

A great deal of attention has been devoted to the subject of the incidence of taxes on imports—confessedly one of the most difficult in economics; and the general result appears to be that only in exceptional cases does the tax fall to an appreciable extent on the foreign producer.[1] It may, and if heavy enough surely will, cut off the foreign supply, and in general such a reduction in supply and lessening of competition will raise prices. On the other hand, account must be taken of competition in the home country itself, and the price may not eventually rise to the full extent of the duty.

§ 12. *Countervailing Duties on Foreign Bounties.*

Another application may be made of this extension of Adam Smith's second exception. He rests the principle of countervailing taxation on the idea that by such a method trade will be simply restored to its natural channels. Later on he justifies the methods of drawbacks on exportation by a similar argument. If the duty is drawn back, it simply restores trade to its natural channels.

It seems to the present writer that this general argument of Adam Smith may be applied to the case of the countervailing duties imposed on bounty-fed sugar. Bounties are most severely condemned by Adam Smith as disturbing the natural course of trade, and ostensibly the object of the countervailing duty is simply to bring back the *status quo ante*. If it be

[1] See *Principles of Political Economy*, Book v. chap. xiii., by present writer.

objected that our consumers benefit by the bounty, and that the bounties only injure the foreign countries which grant them, Adam Smith would reply that it is not to our advantage that other nations should adopt bad economic methods, and that the richer its neighbours so much the better for any trading nation; a principle to which he constantly appeals. We have also to consider the interests of British producers engaged in the sugar industries. In theory, a bounty is a negative tax; and if the home producer ought to be compensated for an excise duty, he ought similarly to be compensated for a bounty given to his foreign rival.

If, however, this extension of the exception is admitted, the way is open for a still wider extension.

§ 13. *Extension of Countervailing Duties.*

It may be said that if foreigners impose taxes on our commodities, and in that way divert trade from its natural channels, we are justified in imposing exactly corresponding duties on the similar goods which they send to us. The justice may be admitted, if justice is to be on the simple plan of an eye for an eye. But the case is, in general, to be decided not on primitive notions of justice but on grounds of expediency. And we are again confronted by the difficulty of the incidence of the proposed taxes.

The case is altered if the taxes on the foreign goods are imposed not merely by way of revenge, in which case they may do more harm than good, but with the idea that the foreign nation may be induced

to take off the offending duties. This leads up to the celebrated exception to free trade that is considered by Adam Smith under retaliation.

§ 14. *Third Exception: Case of Retaliation.*

"As there are two cases in which it will generally be advantageous to lay some burden on foreign for the encouragement of domestic industry, so there are two others in which it may sometimes be a matter of deliberation; in the one how far it is proper to continue the free importation of certain foreign goods, and in the other, how far or in what manner it may be proper to restore that free importation, after it has been for some time interrupted." The first is the case for retaliation.

"The case in which it may sometimes be a matter of deliberation how far it is proper to continue the free importation of certain foreign goods, is when some foreign nation restrains by high duties or prohibitions the importation of some of our manufactures into their country. Revenge in this case naturally dictates retaliation, and that we should impose the like duties and prohibitions upon the importation of some or all of their manufactures into ours. Nations accordingly seldom fail to retaliate in this manner." Here, as usual, Adam Smith appeals to history, and shows by important cases the dangers of the plan. A war of tariffs, begun by the great Colbert, led to a real war with Holland, and after six years' fighting (1672-1678) there was a mutual reduction of duties.

About the same time the French and English began mutually to oppress each others industry, and the hostility continued until, under the influence of Adam Smith's teaching, Pitt made the celebrated commercial treaty with France in 1784.

This is no doubt ancient history, but it is important to notice that the appeal to experience is of the last importance in dealing with the policy of retaliation.

§ 15. *When Justified.*

"There may be good policy in retaliations of this kind when there is a probability that they will procure the repeal of the high duties or prohibitions complained of. The recovery of a great foreign market will generally more than compensate the transitory inconveniency of paying dearer for a short time for some sorts of goods."

There can be no question of the justification by Adam Smith of the principle of retaliation, and the reason assigned is quite in harmony with his general position. The retaliation is only expedient if thereby it is likely that the great foreign market may be restored. Retaliation that fails is worse than useless.

§ 16. *Difficulties of.*

"When there is no probability that any such repeal can be procured, it seems a bad method of compensating the injury done to certain classes of our people, to do another injury ourselves, not only to those classes but to almost all the other classes of them. When our neighbours prohibit some manufac-

ture of ours we generally prohibit not only the same, for that alone would seldom affect them considerably, but some other manufacture of theirs. This may, no doubt, give encouragement to some particular class of workmen among ourselves, and by excluding some of their rivals may enable them to raise their price in the home market. Those workmen, however, who suffered by our neighbours' prohibition will not be benefited by ours. On the contrary they, and almost all the other classes of our citizens, will thereby be obliged to pay dearer than before for certain goods. Every such law, therefore, imposes a real tax upon the whole country not in favour of that particular class of workmen who were injured by our neighbours' prohibitions, but of some other class."

Attention has already been called to the danger of the retaliation being initiated by "that insidious and crafty animal vulgarly called a statesman or politician," and the recent history of tariff wars shows that it is very difficult to put the plan of retaliation into effective operation.

§ 17. *Retaliation on other Grounds—examined.*

In our own times those who advocate retaliation seem to rely less on the idea of the recovery of a foreign market than on the idea of excluding the foreigner by way of natural revenge from our markets. This, however, is to reduce retaliation to the ordinary case of protection to native industries. It is not the kind of retaliation of which Adam Smith approves, but of the kind which he explicitly

condemns. By retaliation Adam Smith means fiscal war—war with the ultimate idea of obtaining some advantage to the nation; the advantage being the recovery of a great foreign market for our exports. Being war it must be carried on for success by the methods of war. A policy of pin-pricks is not war, and may not even lead to war.

If, under present conditions, England resolves to adopt the method of retaliation, it should be prepared to suffer some temporary loss, and strike hard at the most vulnerable part of the enemy's trade. A small *ad valorem* duty on all imports might possibly be a good source of revenue, and, more probably, a good beginning for a reversion to ordinary protection, but it certainly would not be retaliation in the sense understood by Adam Smith; for the simple reason that it would have no influence whatever in inducing other nations to take off their duties; on the contrary it would probably lead most of them to make an increase. Real retaliation would consist in inviting some particular country (say Germany) to take off or reduce objectionable duties, with the indication that if the invitation were declined this country would impose duties which would be intended to be injurious to German trade. We might, for example, threaten to renew the old Navigation Act so far as Germany was concerned. Such retaliation, to judge by the history of the past, would be more likely to end in heavier duties being imposed against us, and might eventually end in real war. Retaliation, however, to be effective, must run risks.

§ 18. *List on Retaliation.*

It is rather remarkable that List should have brought forward one of the strongest objections to retaliation as advocated by Adam Smith. In commenting on Adam Smith's position, List says: "The principle of retaliation is reasonable and applicable only if it coincides with the principle of the industrial development of the nation, if it serves, as it were, as an assistance to this object." His reason is that otherwise the retaliating nation would run the risk of establishing industries unsuited to the country, industries which could only be disestablished at a loss if the retaliation was successful in the way supposed by Adam Smith.

This consideration naturally leads to the second exception which Adam Smith thinks may be worthy of deliberation; this may be briefly described as the case of vested interests.

§ 19. *Fourth Exception: Case of Vested Interests.*

"The case in which it may sometimes be a matter of deliberation how far or in what manner it is proper to restore the free importation of foreign goods after it has been for some time interrupted, is when particular manufactures, by means of high duties or prohibitions upon all foreign goods which can come into competition with them, have been so far extended as to employ a multitude of hands. Humanity may in this case require that the freedom of trade should be restored only by slow

gradations and with a good deal of reserve and circumspection."

As already observed, it is in the interests of labour that Adam Smith advocates this cautious restoration of free trade. He gives reasons, however, why it may be supposed that the disorder caused by the abolition of protection would not be so considerable as is commonly imagined. These reasons amount to the assertion that there is always a certain degree of mobility of labour and that other employments will be available. This guarded statement of Adam Smith has been too often converted by popular writers into an axiom, and it has been taken for granted that in all cases there will be available other employment in other things. It is at this point that the famous prophecy occurs on the improbability of the establishment of perfect free trade in Britain. If by free trade is meant the absence of differential duties this prophecy has been completely upset.

"To expect, indeed, that the freedom of trade should ever be entirely restored in Great Britain is as absurd as to expect that an Oceana or Utopia should ever be established in it. Not only the prejudices of the public, but what is much more unconquerable, the private interests of many individuals irresistibly oppose it."

§ 20. *Extension of the Principle of Vested Interests.*

The principle at the basis of this exception may also be extended to other cases. In the first place it may be argued that if an old-established industry

is threatened by the opening up of some new foreign source of supply, temporary protection may be desirable in the interests of the labour that is employed.

And here we find another justification for the protection afforded by continental nations against the cheap supplies of food from new countries. As already pointed out England repealed the Corn Laws at a time when every one believed that the country must still rely in the main on her own agriculture.

§ 21. *Fifth Exception: Case of Infant Industries.*

The other application is to the case of infant industries, the exception to free trade generally associated with the name of John Stuart Mill. Here the practical difficulty is that the period of infancy is never passed, or vested interests are created which can never be got rid of. The danger is confirmed by the recent history of the United States and Canada. Adam Smith allows that a country by protection may acquire manufactures sooner than it otherwise would do, but he does not suppose that it would make on the whole such rapid progress.[1] The labour and capital would not be used in the best manner, and in consequence neither population nor capital would increase so rapidly. The slow progress of the

[1] This is one of the positions of Adam Smith contested by Alexander Hamilton, who emphasised the necessity of the growth of manufactures (aided by protection) even from the point of view of the growth of capital. In the case of the United Kingdom at present this case is of theoretical interest only. In the case of the British colonies, however, it is of the greatest practical importance, and is examined in detail below (Chapter XVI.).

Australasian colonies compared with what might have been expected seems to confirm this view.

§ 22. *Significance of the "Exceptions" to Free Trade.*

It is a common mistake to look on the exceptions examined in this chapter as of no practical importance, and as having no effect on the general argument in favour of free trade. The truth, as confirmed by history, is that the actual policy of different nations has been determined not by the rule but by the exception. Germany protects her agriculture partly for defence, partly for the sake of the vested interests involved; all our self-governing colonies insist on the protection of infant industries; the United States has defended its protective system by all the exceptions in turn, beginning (under Hamilton) with defence. All the protectionist nations make much of the power of retaliation; and all of them are prevented from lowering their duties by the vested interests of capital.

CHAPTER XII

THE STATE IN RELATION TO COMMERCE

§ 1. *General View of Economic Functions of the State.*

In his fifth book Adam Smith discusses the expenses of the sovereign or commonwealth in the performance of admitted public duties and the sources from which the necessary revenue may be obtained. A great part of this book deals with topics beyond the scope of the present work, *e.g.* the expense of the administration of justice, of educational and religious establishments, etc.; but there are certain leading ideas which throw light on his views on colonial and imperial policy, and form a fitting introduction to that subject.

§ 2. *The State and Commerce.*

The first fundamental position of Adam Smith in treating of the relations of the state to commerce is that for the development and maintenance of commerce certain public works and institutions are necessary which it can never be the interest of any individual or small number of individuals to maintain.

If under natural conditions private enterprise is sufficient, the intervention of the state is worse than useless. But private enterprise presupposes profit, and profit is not always the test of public advantage. The state can undertake works of public utility which not only yield no profit but may be a source of permanent expense. Again, the state can look to a more distant future for a return, and the return need not be measured only in terms of money. Accordingly, the intervention of the state may be justified as supplementary to private effort.[1]

In the second place Adam Smith shows that some commercial undertakings are unsuited for private effort on account of the abuses that are likely to arise. If, for example, any undertaking is likely to acquire a practical monopoly, some kind of state regulation is necessary. And, on the other hand, monopolies may be granted for a limited time, as in the case of patents or copyrights or charters to companies.

§ 3. *General Rule: Non-interference still prevails in spite of Extension of State Regulation.*

On the whole, however, apart from such generally admitted cases as the management of the currency, the provision of roads and the like, Adam Smith does not approve of any wide extension of the industrial domain of the state. Commerce should be left to the merchants, and the state should only intervene in case of need or to check abuses.

[1] These are the economic principles appealed to in support of the Development Fund of the Budget of 1909.

And just as the state should not as a rule interfere in the affairs of commerce—but *laisser faire laisser passer*—so also the merchants should not as a rule interfere in affairs of the state. Since Adam Smith's time the necessary functions of the state, as regards the regulation of industry and commerce, have been widely extended, and with general approval the intervention has gone far beyond what may be called necessary. In spite, however, of this wide extension of state management this presumption still survives; for if it did not, it would mean that state socialism was approved generally as the ideal—which, in regard to British public opinion, as a statement of fact, is of course absurd. In the present work these wider aspects of the relations of the state to industry in general may be passed over;[1] but some attention must be given to Adam Smith's converse proposition that merchants should not interfere with the proper functions of the state.

§ 4. *Merchants not fit to undertake the Duties of the Sovereign Power.*

It was to enforce this teaching with special reference to the case of India that Adam Smith introduced into his third edition a history of the great foreign trading companies which played such an important part in the expansion of the British Empire.[2]

"The protection of trade in general has always

[1] The subject is treated by the present writer in *Principles of Political Economy*, Book v., and in the *Cambridge Modern History*, vol. x. chap. xxiv., "On the British Economists."

[2] Book v. chap. i. part iii. art. i.

been considered as essential to the defence of the commonwealth, and upon that account a necessary part of the duty of the executive power. The collection and application of the general duties of customs, therefore, have always been left to that power. But the protection of any particular branch of trade is a part of the general protection of trade; a part, therefore of the duty of that power; and if nations always acted consistently the particular duties levied for the purposes of such particular protection should always have been left equally to its disposal. But in this respect, as well as in many others, nations have not always acted consistently; and in the greater part of the commercial states of Europe particular companies of merchants have had the address to persuade the legislature to entrust to them the performance of this part of the duty of the sovereign, together with all the powers which are naturally connected with it. These companies, though they may perhaps have been useful for the first introduction of some branches of commerce by making at their own expense an experiment which the estate might not think it prudent to make, have in the long run proved universally either burdensome or useless, and have either mismanaged or confined the trade."

§ 5. *History and Abuses of Foreign Trading Companies: Regulated Companies.*

This opinion is supported by an appeal to history. An account is given first of the old "regulated"

companies, which resembled the corporations of trades which used to be common in all the cities and towns of Europe. The foreign regulated trading companies were fashioned exactly in their likeness. To trade in a certain "sphere" a merchant must be admitted a member of the company, and gradually by raising the fees the entrance was restricted and a partial monopoly created. In these regulated companies, however, the members traded independently, subject to certain general rules and regulations. The conclusion of the history of these regulated companies is given in the famous verdict: "To be merely useless, indeed, is perhaps the highest eulogy which can ever be justly bestowed upon a regulated company; and all the three companies above mentioned seem in their present state to deserve this eulogy."

These regulated companies did not maintain forts or garrisons in the countries to which they traded; but they sometimes contributed to the expense of maintaining ambassadors or consuls "who, like other public ministers, ought to be maintained altogether by the state and the trade laid open to all His Majesty's subjects. The different taxes levied by the company [the reference is to the Turkey company] for this and other corporation purposes might afford a revenue much more than sufficient to enable a state to maintain such ministers."

§ 6. *Joint-Stock Companies—East India Company.*

The joint-stock companies for foreign trade, as the name implies, carried on their operations so that

each member shared in the profit or loss in proportion to the amount of his shares.

The most important of these companies was the East India Company, which began (1600) as a regulated company, but after a very short time was converted into a joint-stock company. The history of this company is part, and a very important part, of the general history of the British Empire. In this place it will suffice to quote, as illustrative of his principles, some of the comments of Adam Smith, without the detailed history on which they are based. The company constantly complained of the competition of interlopers. "The miserable effects of which the company complained were the cheapness of consumption and the encouragement given to production; precisely the two effects which it is the great business of political economy to promote. The competition, however, of which they gave this doleful account, had not been allowed to be of long continuance." By the aid of their monopoly the company made a fair profit during the first part of the eighteenth century, but they gradually became involved in the politics of the Indian princes, and with politics came wars. "After many signal successes and equally signal losses they at last lost Madras, at that time their principal settlement in India. It was restored to them by the treaty of Aix-la-Chapelle (1748); and about this time the spirit of war and conquest seems to have taken possession of their servants in India and never since to have left them." After the French war (1755 to 1762) we are told: "The great increase

of their fortune had, it seems, only served to furnish their servants with a pretext for greater profusion and a cover for greater malversation than in proportion even to that increase of fortune. The conduct of their servants in India and the general state of their affairs, both in India and in Europe, became the subject of a parliamentary inquiry; in consequence of which several very important alterations were made in the constitution of their government, both at home and abroad." . . . "But it seems impossible, by any alterations, to render those courts in any respect fit to govern or even to share in the government of a great empire; because the greater part of their members must always have too little interest in the prosperity of that empire to give any serious attention to what may promote it."

"Frequently a man of great, sometimes even a man of small fortune, is willing to purchase a thousand pound share in India stock merely for the influence which he expects to acquire by a vote in the court of proprietors. It gives him a share, though not in the plunder, yet in the appointment of the plunderers of India. . . . Provided he can enjoy this influence for a few years, and thereby provide for a certain number of his friends, he frequently cares little about the dividend or even about the value of the stock on which it is based. About the prosperity of the great empire in the government of which that vote gives him a share, he seldom cares at all. No other sovereigns ever were or from the nature of things ever could be so perfectly indifferent about the

happiness or misery of their subjects, the improvement or waste of their dominions, the glory or disgrace of their administration, as from irresistible moral causes the greater part of the proprietors of such a mercantile company are and necessarily must be." With the mismanagement of sovereign power was associated mismanagement of trade, so that "in consequence of these disorders the company is now (1784, the date of Adam Smith's third edition) in greater distress than ever. . . . Different plans have been proposed by the different parties in Parliament for the better management of its affairs, and all those plans seem to agree in supposing what was, indeed, always abundantly evident, that it is altogether unfit to govern its territorial possessions."

§ 7. *General View of Relation of Trade to Sovereignty.*

"No two characters seem more inconsistent than those of trader and sovereign. If the trading spirit of the English East India Company renders them very bad sovereigns, the spirit of sovereignty seems to have rendered them equally bad traders."

The present condition of India under British rule is the best commentary on the soundness of Adam Smith's judgment. The government of the millions of India by a few thousand British civilians is one of the greatest marvels in the history of civilisation; and one of the essential conditions of success is that the delegates of the sovereign have no share in the profits of the exploitation of the country. Equally

strong, from the negative standpoint, is the example of the Congo State. The proposition that sovereigns make bad traders is only a variant on the better-known proposition that for the state to direct private people in what manner they ought to employ their capitals must in almost all cases be either a useless or a hurtful regulation.

§ 8. *Adam Smith's Appreciation of the Founders of the Indian Empire.*

It must not be supposed that Adam Smith did not appreciate the difficulties and the merits of those who laid the foundations of our Indian empire, as is evidenced by the passage which forms the conclusion of the chapter on colonies and colonial policy.[1] "I mean not, however, by anything which I have here said to throw any odious imputation upon the general character of the servants of the East India Company, and much less upon that of particular persons. It is the system of government, the situation in which they are placed, that I mean to censure, not the character of those who have acted in it. They acted as their situation naturally directed, and they who have clamoured the loudest against them would probably not have acted better themselves. In war and negotiation the councils of Madras and Calcutta have upon several occasions conducted themselves with a resolution and decisive wisdom which would have done honour to the Senate of Rome in the best days of that republic. The members of those councils,

[1] Book IV. chap. vii.

however, had been bred to professions very different from war and politics. But their situation alone, without education, experience, or even example, seems to have formed in them all at once the great qualities which it required, and to have inspired them both with abilities and virtues which they themselves could not well know they possessed."

But the conclusion of the whole matter is that: "Such exclusive companies are therefore nuisances in every respect; always more or less inconvenient to the countries in which they are established, and destructive to those who have the misfortune to fall under their government." [1]

[1] See *Principles of Political Economy*, vol. ii. Book III. chap. xxiv. on history of chartered companies for fuller treatment of this subject by the author.

CHAPTER XIII

ADAM SMITH ON COLONIAL POLICY

§ 1. *Historical Conditions Affecting the Composition of the "Wealth of Nations."*

THE first edition of the *Wealth of Nations* was published on the 9th of March 1776; the Declaration of the Independence of the American Colonies was made on July 4 of the same year. This independence was recognised in 1783; and in 1784 the third edition of the *Wealth of Nations* was published with some considerable additions and alterations by the author, after which he made no more than verbal corrections.

The composition of the *Wealth of Nations* was spread over at least the twenty-seven years from 1749 to 1776, and from the former date to the death of the author in 1790 occurred the most important events connected with the building up of the British Empire,—on the one side the acquisition of India and on the other the loss of the North American Colonies, both the results of a long series of cumulative causes broken by catastrophic accidents. This was the period also when the storm of ideas was gathering which burst in the great French Revolution, and the

period which in England culminated in what is called the Industrial Revolution.

§ 2. *Adam Smith's Appreciation of History and Foresight.*

Adam Smith wrote in the midst of great events, and in the shadows of even greater coming events. "The discovery of America and that of a passage to the East Indies by the Cape of Good Hope are the two greatest and most important events recorded in the history of mankind. Their consequences have already been great; but in the short period of between two and three centuries which has elapsed since these discoveries were made it is impossible that the whole extent of their consequences can have been seen. What benefits or what misfortunes to mankind may hereafter result from those great events no human wisdom can foresee."

This passage is immediately preceded by the forecast that in little more than a century, judging by the rapid progress already made in wealth, population, and improvement, the American Colonies might surpass Britain; so that if representation were proportioned to taxation, according to Adam Smith's scheme of imperial federation, "the seat of the empire would naturally remove itself to that part of the empire which contributed most to the general support and defence of the whole." The material progress of the United States has been of the magnitude indicated, though the separation has at any rate deferred the problem of the transfer of the seat of empire. The

passage quoted is also immediately followed by a remarkable forecast as to the possible development of the nations of the East. "At the particular time when these discoveries were made, the superiority of force happened to be so great on the side of the Europeans that they were enabled to commit with impunity every sort of injustice in those remote countries. Hereafter, perhaps, the natives of those countries may grow stronger and those of Europe may grow weaker; and the inhabitants of all the different quarters of the world may arrive at that equality of courage and force which by inspiring mutual fear can alone overawe the injustice of independent nations into some sort of respect for the rights of one another. But nothing seems more likely to establish this equality of force than that mutual communication of knowledge and of all sorts of improvements which an extensive commerce from all countries to all countries naturally or rather necessarily carries along with it." The sudden rise of Japan to a first-class power, the awakening of China, and the unrest in India confirm the soundness of this anticipation. If the "short period" of two or three centuries before 1776 witnessed remarkable changes, a similar short period from our own times is likely to witness changes still more remarkable.

§ 3. *Bearing of Argument on Present Situation.*

The treatment by Adam Smith of the fundamental questions of colonial and imperial policy ought to throw light on our present problems. Let those who

reflect that Adam Smith has been dead more than a hundred years remember that in the life of a nation a hundred years may be a short period. And in the matter of imperial policy Adam Smith is still in advance of the practical political leaders of our own time. In other matters we have reached or approached the level of Adam Smith's ideals; we have abandoned prohibitions and high duties for protection and simplified revenue duties; we have enforced universal elementary education; we have improved the mobility of labour and are beginning to organise the labour market; we have reformed the old feudal land laws, some altogether and some partially; we have introduced progressive taxation; and we are beginning to think of the taxation of unearned increments and monopolies; but we have not yet realised the meaning of Adam Smith's ideas on colonial policy, and seem rather inclined to revert to an older set of ideas which he regarded as worn out.

§ 4. *Reasons for Colonisation, Ancient and Modern.*

The chapter on colonial policy[1] is one of the longest in the book, and is supplemented by the chapter which forms the fitting conclusion to the whole work.[2]

Before extracting the leading ideas for present use attention may be called to the method of treatment. It is one of the best examples of the application of the historical method. In Part I. of this chapter on Colonies an admirable history is given of the motives for establishing new colonies in ancient and in modern

[1] Book IV. chap. vii. [2] Book V. chap. iii.

times. There is the old Greek plan of relieving the population of the cities, with their contracted sources of food-supplies, by organised swarming in the manner of bees, the new colonies being given practical independence. There is the opposite plan which was used to weld together the Roman empire with its intricate military and political organisation and a centralisation which in the end proved fatal. There is the modern European method or (in its origins) want of method with colonies founded partly by private adventurers in search of gain, especially gold and silver, and partly by political and religious outcasts in search of freedom; all other objects being finally subordinated to the idea of making the monopoly of the colonial trade a perquisite of the mother country.[1]

§ 5. *Causes of Prosperity of New Colonies.*

In Part II. of this chapter Adam Smith examines the causes of prosperity of new colonies, and the inquiry is extended to ancient as well as to modern times, and illustrations are taken from all parts of the world.

The general reasons assigned for the rapid progress of the colonies of civilised nations planted in waste or thinly peopled countries are those which have been examined at length in dealing with "the nature and causes of the wealth of nations." The colonists take out with them an advanced knowledge of agriculture

[1] Cf. Cunningham, vol. ii. p. 119, on the origin of "plantations" due to Englishmen in search of new lands and new homes.

and other useful arts; and they carry out with them also more advanced notions of subordination to government and law. The emphasis by Adam Smith of the importance of law and government is noteworthy. "Among savage and barbarous peoples the natural progress of law and government is still slower than the natural progress of the arts, after law and government have been so far established as is necessary for their protection." Next to these various forms of immaterial capital, there is the abundance of undeveloped land. "Every colonist gets more land than he can possibly cultivate." With the abundance of land wages are naturally high, and with the high wages there is a rapid increase in population. "In other countries rent and profit eat up wages, and the two superior orders of people oppress the inferior one"; but in new colonies the interest of the two superior orders obliges them to treat the inferior one "with more generosity and humanity at least where that inferior one is not in a state of slavery." Later on, Adam Smith shows that even as regards the slaves good treatment is good economy; the French sugar plantations were better, so far, than the English, because their slaves were better treated.

All new colonies have made rapid progress under good conditions whatever their origins; *e.g.* the French colony of St. Domingo was established by pirates and freebooters, and when they at last acknowledged the authority of France "these banditti had to be treated with great gentleness," and yet the population and improvement of the colony increased very fast. Other

instances of progress are given, "but there are no colonies of which the progress has been more rapid than that of the English in North America. Plenty of good land and liberty to manage their own affairs their own way seem to be the two great causes of the prosperity of all new colonies."

§ 6. *Special Causes of Rapid Progress of North American Colonies.*

Special causes are given why these colonies have prospered relatively to others: the lands have not been so much engrossed; there has been greater freedom of alienation and freedom from entails and family settlements; "the engrossing of land destroys its plenty and cheapness, and the engrossing of uncultivated land is the greatest obstruction to its improvement." The expenses of government in these colonies have been relatively small.

"All the different civil establishments in North America, exclusive of those of Maryland and North Carolina, did not before the commencement of the present disturbances cost the inhabitants above £64,700 a year; an ever-memorable example at how small an expense three millions of people may not only be governed but well governed." The commercial policy of the mother country allowed the colonists much greater freedom relatively as is shown in detail; some nations have granted the commerce of their colonies to exclusive companies, "the most effectual of all expedients for stunting the growth of a colony"; some have confined the colonial commerce to particular

ports; "but though the policy of Great Britain, with regard to the trade of her colonies, has been dictated by the same mercantile spirit as that of other nations it has, however, upon the whole, been less illiberal and oppressive than any of them. In everything except their foreign trade the liberty of the English colonists to manage their own affairs in their own way has been complete."

This examination of the causes of the prosperity of new colonies is summarised in a most graphic passage, and culminates in the question: "In what way, therefore, has the policy of Europe contributed either to the first establishment or to the present grandeur of the American colonies? In one way and in one way only it has contributed a great deal. *Magna virûm mater.* It bred and formed the men who were capable of achieving such great actions and of laying the foundation of so great an empire."

§ 7. *Advantages to Europe of Colonies in New Countries.*

In Part III. of the same chapter Adam Smith discusses the advantages which Europe has derived from the discovery of America and of a passage to the East Indies by the Cape of Good Hope. These advantages may be divided into two groups: general and national. The general advantages are those that emerge from the natural development of foreign trade: the increase of consuming power and the augmentation of industry with an increase of the employment of productive labour in the old countries. Even those

nations which had no direct trade with these new countries, and did not even obtain colonial produce indirectly for consumption, had gained by the increase in the wealth of their neighbours.

§ 8. *National Advantages from Colonies in Military Power or Revenue not realised.*

The general advantages to Europe have been undoubted; but when we come to the peculiar and special advantages which each nation might have been expected to derive from the possession of colonies and dependencies the case is altered.

It is this part of the treatment of colonial policy which has a vital interest at the present time.

"The common advantages which every empire derives from the provinces subject to its dominion consist, first, in the military force which they furnish for its defence; and secondly, in the revenue which they furnish for the support of its civil government. The Roman colonies furnished occasionally both the one and the other. The Greek colonies sometimes furnished a military force, but seldom any revenue. They seldom acknowledged themselves subject to the dominion of the mother city. They were generally her allies in war, but very seldom her subjects in peace." But when we come to the colonies of European nations in modern times we find that they have never yet furnished any military force for the defence of the mother country. The military force has never yet been sufficient for their own defence; and in the different wars in which the mother countries have been

engaged the defence of their colonies has generally occasioned a very considerable distraction of the military force of those countries. In this respect, therefore, all the European colonies have without exception been a cause rather of weakness than of strength to their respective mother countries." So much for the increase of military power. As regards revenue, "the colonies of Spain and Portugal only have contributed any revenue towards the defence of the mother country or the support of her civil government. The taxes which have been levied on those of other European nations—upon those of England in particular—have seldom been equal to the expense laid out upon them in time of peace, and never sufficient to pay that which they occasioned in time of war.[1] Such colonies, therefore, have been a source of expense and not of revenue to their respective mother countries."

As is shown at the conclusion of Book V., in the two wars against Spain and France, the American colonies cost Great Britain much more than double the sum which the national debt amounted to before the commencement of the first of them (1739). "Had it not been for those wars the debt might and probably would by this time (1776) have been completely paid; and had it not been for the colonies the former of these wars might not, and the latter certainly would not, have been undertaken." This short commentary has been developed in Seeley's popular essay on the *Expansion of England*, and it is hardly necessary to point out, with the South African addition to the

national debt still unpaid, that it is the colonies and dependencies which still form the great source of expense to Great Britain. At the conference of colonial premiers in London in 1897 Mr. Chamberlain, as Colonial Secretary, is officially reported as saying: "You will find that every war, great or small, during the reign of Victoria, in which we have been engaged has had at bottom a colonial interest, that is to say, either of a colony or of a great dependency like India. This is absolutely true, and is likely to remain true to the end of the chapter. If we had no empire there is no doubt that our military and naval resources would not require to be maintained at anything like the present level."[1]

Reverting to the main argument of Adam Smith, it is clear that when he wrote the great colonising nations of Europe, and notably England, had gained nothing either in military strength or in revenue from the possession of colonies, but on the contrary had suffered loss and accumulated debt.

§ 9. *Supposed Advantage of the Monopoly of the Colonial Trade examined.*

But at that time it was firmly believed that each particular colonising country had gained a special and peculiar advantage from the monopoly of its colonial trade.

The greater part of the remainder of Adam Smith's chapter on colonies is devoted to an examination of this contention; and the general result of the examina-

[1] *Report of Proceedings*, C—8596.

tion is that this boasted monopoly had itself also been a source of loss to the mother country on the whole. England, for example, in Adam Smith's opinion had, it is true, by the maintenance of the monopoly against foreign countries gained over them a certain relative advantage in that branch of commerce; but his main point is that, in securing this relative advantage, an absolute advantage of greater magnitude had been sacrificed.

The revolt and subsequent separation of the American colonies was the beginning of the total abandonment of the monopoly of the colonial trade, and in the course of time the self-governing colonies have acquired the right, and exercised it, of imposing protective duties against the mother country.[1] The absolute change in policy is shown specially in the case of manufactures. Under the old system the colonies, with few exceptions, were not even allowed to manufacture for themselves if they had the means or the inclination; they were regarded as the great closed market for the manufacturers of the home country. At the present time the manufactures of the mother country are subject to very heavy import duties, and the utmost relaxation consists in a preferential duty as compared with nations politically foreign.

§ 10. *Present Importance of the Argument.*

Adam Smith's argument on the monopoly of the colonial trade is intricate and difficult, but it is well

[1] See below, Chapter XV.

worthy of careful study, for two reasons. In the first place, at the present time, the idea is again beginning to find favour that in the interests of the mother country, and the empire, the system of monopoly as against foreign countries ought to be partially restored. It ought, therefore, to be of interest and of utility to consider the effects of the monopoly when in its full vigour. In the second place, the argument of Adam Smith rests almost entirely on those principles on the relative advantages of employing the capital of the country which he always considered fundamental, and which after being lost sight of or ignored for a long period are again reasserting their practical importance.

Whether Adam Smith's diagnosis of the actual effects of the old system was correct or not is for the present purpose of less importance than the consideration how far the ideas which he applied are applicable to our present case.

§ 11. *Effects of Monopoly must be separated from the Natural Effects.*

In treating of the economic effects of the colonial monopoly Adam Smith always distinguishes between the effects of the natural trade and the effects due solely to the monopoly. In his judgment the former are, in general, always advantageous, in the latter the total effect is injurious to the nation as a whole and to the great classes of which it is composed. The natural trade was also of advantage to the colonies, and in their case there were compensating advantages

from the monopoly, and most of the oppressive regulations were inoperative.[1]

It is to be observed that Adam Smith, having already disposed of the political aspects of the question relating to military power and revenue, is now concerned solely with the commercial aspects.

Throughout the argument it is taken for granted that for the home country it is advantageous that its capital should be employed, first of all, in home industries, but that the surplus may with advantage be sent into these distant colonial trades; also, capital may be turned with advantage into these distant places if in return the home country obtains valuable products, especially raw materials, which it could only acquire for itself, if at all, at a much greater cost. If at any time under natural conditions the rate of profits in the colonial trade was unduly high that would show that in the circumstances of the society the people were obtaining these colonial products at an excessive cost. If the cost fell by the development of the trade the cost of manufactures in the home country would fall, and the exports to other markets would be increased, and in this way indirectly the home country would obtain more capital and give greater employment to home labour. So far, of course, the argument would apply equally to the development of any foreign trade through which we gained an increase either in consuming or in productive power.

This consideration is of great importance in the examination of the effects at present of foreign

[1] See below, § 15.

investments of British capital. In the meantime, however, attention must be directed to the effects of interference with this natural trade by means of the various devices summarised under the monopoly of the colonial trade.

§ 12. *General Effects of the Monopoly.*

Adam Smith's central position is that by this monopoly capital is unduly forced from its natural employment either at home or in more favourable foreign trades (all the circumstances being taken into account) into these colonies. The reason is, that the monopoly gives exceptional profit, and capital always follows profit. The next consequence of this artificial diversion of capital is that there is relatively a deficiency for the home and other natural employments, and accordingly the profit in these employments also rises. The final result is that this rise in profit, now becoming general, raises the cost of production of all other things including our exports. In this way our exports to foreign countries are diminished, and we are undersold in the near and favourable markets in commodities for which we have special aptitudes. Here we have the *locus classicus*: "Our merchants complain of high wages of British labour as causes of underselling in manufactures, but they are silent about high profits of stock." The essence of the argument is that the natural trade lowers cost, the monopoly raises it.

§ 13. *Disadvantage of high rate of Profit.*

That the *causa causans* of the disadvantage of the monopoly is the general rise in the rate of profit is incidentally, at any rate, decisive as to the distinction drawn by Adam Smith between profit and advantage. The great mercantilist writer, Thomas Mun, in his *England's Treasure by Foreign Trade*, had argued that the more distant trades were more advantageous, simply because they yielded a higher rate of profit. Adam Smith, on the contrary, held that so far as distance was concerned, though the profit might be greater, the advantage to the country was less, because the capital being kept longer out of the country gave less employment to productive labour, and was not to the same extent consumed and reproduced within the country itself.

§ 14. *Effects of Monopoly on Rents, Wages, and Profits.*

That there might be no doubt as regards the main contention, Adam Smith shows in detail that all the great classes of the society suffer from the artificial stimulus given to the general rate of profit. Rents are reduced because the farms must get the ordinary rate of profit (allowance being made as before for the amenities of agriculture); the price of land falls doubly, partly from the fall in rent, partly from the rise in the interest on capital in general; labour also suffers doubly, first by lessened employment through the contraction of the home supply of capital; and

secondly, because in the division of the annual produce of the land and labour a greater share goes to capital; and lastly, even the owners of capital suffer as a class because the artificially high rate stimulates extravagance and checks parsimony, so that at the end of any given period the capital of the country is less than otherwise would have been the case, and as shown before, the rise in cost of production hinders the natural development of certain industries. Another point emphasised is that one colonial market is less stable than a number of foreign markets.

§ 15. *Effects of the Monopoly in the Colonies.*

It has already been pointed out that in Adam Smith's opinion one principal reason why the English colonies prospered more than those of other countries is that in their case the monopoly and consequent restrictions imposed by the mother country were much less stringent.

But from the colonial point of view this artificial diversion of British capital into their lands and extractive industries must also have had its positive advantages; the loss to Britain, so far, must have been a gain to the colonies. This point has been well brought out by Professor Ashley in his essay on "The Relations of England and America, 1660-1760."[1] He quotes from the third book of Adam Smith the fruitful sentence: "The progress of our North American and West Indian colonies would have been

[1] *Economic Surveys*, p. 332.

much less rapid had no capital but what belonged to themselves been employed in exporting their surplus produce." He quotes also from Burke's celebrated speech on American taxation in 1774, in which, after noting that America had tolerated the system of commercial restraint, he says: "They were indemnified for it by a pecuniary compensation. Their monopolist happened to be one of the richest men in the world. By his immense capital (primarily employed not for their benefit but for his own) they were enabled to proceed with their fisheries, their agriculture, their shipbuilding (and their trade, too, within the limits) in such a manner as got far start of the slow, languid operations of unassisted nature. This capital was a hotbed to them. Nothing in the history of mankind is like their progress." And Professor Ashley also quotes the significant admission by Adam Smith, that unjust as the prohibitions of the monopoly may have been, they have not hitherto been very hurtful to the colonies; and Professor Ashley's own judgment is, that prior to 1760 the English commercial legislation did the colonies no harm, and the English connection did them much good.

At the same time, however, as Dr. Cunningham shows, the restraints, if not a source of material damage, were a source of irritation to the colonies when they approached the age of self-reliance and were seized with the spirit of national independence.[1]

In the present work of which, as often indicated,

[1] Cunningham, vol. ii. p. 583 *sq.*

the object is to extract ideas for present use, it is not necessary to go into all the details of the old colonial monopoly. A fuller examination would show that in general it was the colonies which gained from any modifications of the leading ideas. Bounties, for example, were given by the mother country on certain colonial exports to this country, *e.g.*, naval stores and materials for shipbuilding and manufactures, and in several cases considerable duties were imposed if the same things were brought to Britain from foreign countries.

On the policy of these bounties Adam Smith has the forcible commentary, of great interest from the point of view of a real union: "The interest of our American colonies was regarded as the same with that of the mother country. Their wealth was considered as our wealth . . . They were our own in every respect, and it was an expense laid out on the improvement of our own property and for the profitable employment of our own people. It is unnecessary, I apprehend at present (1784), to say anything further in order to expose the folly of a system which fatal experience has now sufficiently exposed."

In the same way England also, in many cases, gave drawbacks on articles imported from foreign countries to England when they were re-exported to the colonies; so that the colonists often obtained foreign products cheaper than the consumers in the home country. Professor Ashley has shown in detail that the regulations of the Navigation Act had the effect of encouraging shipbuilding in the American colonies,

and that with one exception the restrictions which might have proved to be injurious were inoperative.

§ 16. *General Summary of Profit and Loss to Britain from the Colonies.*

When on the eve of the declaration of independence of the American colonies Adam Smith was taking a broad survey of the economic position of the British Empire and its constituent parts, he was forced to the conclusion that the mother country, through this extension of empire, had gained nothing in military power or in revenue for the general advantage of the empire, and in fact had suffered loss as shown by the great increase in the national debt. As regards the monopoly two more sentences may be quoted of the nature of a general summary. "In the exclusive trade it is supposed consists the great advantage of provinces which have never yet afforded either revenue or military force for the support of the civil government or the defence of the mother country." But as regards the results of this exclusive trade we are told: "Under the present system of management, therefore, Great Britain derives nothing but loss from the dominion which she assumes over her colonies." Even as regards trade the monopoly has only displaced a more advantageous trade with Europe; and not increased the aggregate volume.

It is admitted that a particular order of men namely, the merchants who trade with the colonies, may have benefited from the monopoly, but their gain has been at the expense of the bulk of the nation.

Nor can this gain be taken from the favoured class by taxation for the benefit of the nation. "The men whose revenue the monopoly increases constitute a particular order which it is both absolutely impossible to tax beyond the proportion of other orders, and extremely impolitic to tax beyond that proportion."

The general result is that the provinces of the British Empire had not contributed, and at the time of writing did not contribute their fair share either towards the ordinary expenses of the civil government of the whole empire, or towards the ordinary expense for their own defence of a permanent character, or towards the extraordinary expense that was incurred in times of war, even though these wars were undertaken on account of the provinces themselves.

And the irony of the whole situation lay in the fact that owing to a variety of causes the principal colonies were preparing the way for political separation from the country to which they owed so much. The irritation caused by the imposition of taxes, ostensibly for imperial purposes, of such small extent that they would not pay the expenses of collection—"peppercorn rents," "shearing the wolf"—was sufficient to cut asunder for ever the ties which it was sought to tighten.

Adam Smith had no illusions as to the weakness of the British Empire, and of the causes of that weakness.

§ 17. *Alternative of Disintegration or Real Union.*

"Countries which contribute neither revenue nor military force towards the support of the empire cannot be considered as provinces. They may perhaps be considered as appendages, as a sort of splendid and showy equipage of the empire . . . The rulers of Great Britain have for more than a century past amused the people that they possessed a great empire on the west side of the Atlantic. This empire has hitherto existed in imagination only. It has hitherto been not an empire but the project of an empire; not a gold mine but the project of a gold mine; a project which has cost, which continues to cost, and which, if pursued in the same way as it has been hitherto, is likely to cost immense expense without being likely to bring any profit. It is surely now time that our rulers should either realise this golden dream in which they have been indulging themselves, perhaps, as well as the people, or that they should awake from it themselves and endeavour to awaken the people. If the project cannot be completed it ought to be given up. If any of the provinces of the British empire cannot be made to contribute towards the support of the whole empire, it is surely time that Great Britain should free herself from the expense of defending those provinces in time of war, and of supporting any part of their civil or military establishments in time of peace; and endeavour to accommodate her

future views and designs to the real mediocrity of her circumstances."[1]

Confronted with this alternative of abandonment or organisation Adam Smith himself had no hesitation. "To propose that Great Britain should voluntarily give up all authority over her colonies and leave them to elect their own magistrates, to enact their own laws, and to make peace and war, as they might think proper, would be to propose such a measure as never was and never will be adopted by any nation in the world . . . The most visionary enthusiasts would scarce be capable of proposing such a measure with any serious hopes at least of its ever being adopted."

If such a separation were to take place by mutual agreement and with guarantees for free trade between the different parts of the disbanded empire, possibly this solution might be the best. The colonies, though not our subjects, in time of peace would at any rate be our good friends and give us the maximum benefit of trade, whilst in time of war they would certainly be our allies; and being left, on this supposition, to provide for their own defence, it is probable that they would be very effective allies. But this alternative of separation is rejected by Adam Smith at once on the grounds of national sentiment.

In the meantime, however, we have gone very near the accomplishment of the feat which Adam Smith declared impossible, and have granted such

[1] Book v. chap. iii.

a degree of self-government to the principal colonies as to leave our sovereignty a shadow of what it was when he complained of the empire as an imaginary project.

His own plan involved a complete scheme of imperial federation; the basis of which was representation in proportion to taxation for imperial purposes.

CHAPTER XIV

THE IMPERIALISM OF ADAM SMITH

§ 1. *The "Shopkeeper" Idea of Empire Criticised.*

"To found a great empire for the sole purpose of raising up a people of customers may at first sight appear a project fit only for a nation of shopkeepers. It is, however, a project altogether unfit for a nation of shopkeepers but extremely fit for a nation whose government is influenced by shopkeepers. Such statesmen, and such statesmen only, are capable of fancying they will find some advantage in employing the blood and treasure of their fellow-citizens to found and maintain such an empire. Say to a shopkeeper, Buy me a good estate and I shall always buy my clothes at your shop even though I should pay somewhat dearer than what I can have them for at other shops, and you will not find him very forward to embrace your proposal. But should any other person buy you such an estate the shopkeeper will be much obliged to your benefactor if he would enjoin you to buy all your clothes at his shop. England purchased for some of her subjects who found themselves uneasy at home a great estate in a distant country. . . . The cultivators became in

little more than thirty or forty years so numerous and thriving a people that the shopkeepers and other traders of England wished to secure for themselves the monopoly of their custom. Without pretending, therefore, that they had paid any part either of the original purchase money or of the subsequent expense of improvement, they petitioned the parliament that the cultivators of America might for the future be confined to their shop; first for buying all the goods which they wanted from Europe; and secondly for selling all such parts of their own produce as those traders might find it convenient to buy. For they did not find it convenient to buy every part of it. Some parts of it imported into England might have interfered with some of the trades which they themselves carried on at home. Those particular parts of it, therefore, they were willing that the colonists should sell where they could; the farther off the better; and upon that account proposed that their market should be confined to the countries south of Cape Finisterre. A clause in the famous Act of Navigation established this truly shopkeeper proposal into law."[1]

This shopkeeper policy, considered as the basis of imperial union, is condemned by Adam Smith first of all on economic grounds as adverse to the interests of the home country. The only people who benefit (*i.e.* from the monopoly) are the mercantile classes who trade with the colonies, the "shopkeepers" who make the colonist buy and sell at their

[1] Book IV. chap. vii.

"shops," and the gain of the particular traders is not transferred to the whole body of the people, but indirectly is adverse to national interests by diverting capital from more advantageous employments. The colonial trade artificially fostered is less advantageous than the foreign trade developed under natural conditions.

§ 2. *The Ideal of Empire not purely Economic.*

In looking at the relations of the mother country to the colonies, from the point of view of empire, Adam Smith also first of all takes up the economic standpoint. From this point of view the adoption of the Greek ideal of colonisation might eventually turn out the best. If the independence of the colonies were allowed "Great Britain would not only be immediately freed from the whole annual expense of the peace establishment of the colonies, but might settle with them such a treaty of commerce as would effectually secure to her a free trade more advantageous to the great body of the people, though less so to the merchants, than the monopoly which she at present enjoys. By thus parting good friends the natural affection of the colonies to the mother country which, perhaps, our late dissensions have well-nigh extinguished, would quickly revive. It might dispose them not only to respect for whole centuries together that treaty of commerce which they had concluded with us at parting, but to favour us in war as well as in trade, and instead of turbulent and factious subjects to become our most faithful,

affectionate, and generous allies; and the same sort of parental affection on the one side and filial respect on the other might revive between Great Britain and her colonies which used to subsist between those of ancient Greece and the cities from which they descended."

In spite, however, of its economic advantages, Adam Smith rejected this scheme of friendly separation as fantastical, and opposed to the fundamental notions of territorial sovereignty. But the actual separation of the greatest of the colonies took place as the result of war and without any provision for free trade; indeed, one of the first ideals impressed on the new republic was that as a nation it must learn to be self-contained, must learn to manufacture and build great cities and not be content to remain a mere agricultural state, even if that were the shortest way to national wealth. This is the great argument of Alexander Hamilton, whose personality, achievements, and ideals have been restored to their proper place and setting in the world's history in the brilliant biography by Mr. F. S. Oliver.

And yet in spite of the dislocation by war in its origin, and of a speedy renewal of war when the republic sided with Napoleon against the mother country, in spite of the divergence of commercial interests and policies and of the more important division of opinion at the time of the great civil war, it is not too much to say that after nearly a century and a half of independence the people of the United States of America have much of the natural affection

so well depicted by Adam Smith for the country of their origin.

And as regards the other colonies, which by the force of circumstances as well as by the fear of example, we have gradually admitted to self-government in all essentials, there can be no question that though only nominal subjects in peace they would be devoted allies in war. And for this purpose even the nominal sovereignty has its advantages, although in the meantime the home country bears a disproportionate part of the burden of defence and in return has not even freedom of trade.

§ 3. *Ideal of British Empire in Development of British Constitution.*

Adam Smith himself, however, did not look upon empire merely from the economic standpoint even when his subject was emphatically the wealth of nations. Writing before the separation was an accomplished fact, and before it seemed likely that it ever would be an accomplished fact, he propounded a scheme of imperial federation which he described as the natural development of the British Constitution. In place of the Greek ideal of friendly disintegration he set up the ideal of Roman organisation with one essential difference; the provision, namely, for the representation of the provinces. It was the absence of this principle of representation which on Adam Smith's view ruined the Roman Empire, and it was in the adoption of this principle that he sought for the nexus that should bind into one the different

parts of the scattered British Empire. "The idea of representation was unknown in ancient times. When the people of one state were admitted to the right of citizenship in another, they had no other means of exercising that right but by coming in a body to vote and deliberate with the people of that other state. The admission of the greater part of the inhabitants of Italy to the privileges of Roman citizens completely ruined the Roman Republic. . . . Though the Roman Republic, therefore, was necessarily ruined by the union of Rome with the allied States of Italy, there is not the least probability that the British Constitution would be hurt by the union of Great Britain with her colonies. That constitution, on the contrary, would be completed by it, and seems to be imperfect without it."[1]

§ 4. *Practical Difficulties.*

There are, Adam Smith admits, very great difficulties in the way. "I have heard of none, however, which appear insurmountable. The principal arise not from the nature of things, but from the prejudices and opinions of the people, both on this and on the other side of the Atlantic." Adam Smith confronts these prejudices, and in spite of them carries his proposal to the logical conclusion. Representation in the Imperial Parliament, "or, if you will, the states-general of the British Empire,"[2] for the conduct of imperial affairs is to be based on taxation, and in proportion to the taxation is to be the representation.

[1] Book IV. chap. vii.

[2] Book V. chap. iii. p. 397.

The difficulties to be met in the establishment of an Imperial Parliament, based on taxation, are boldly faced and boldly answered. The people on this side, he says, are afraid that in the course of time the balance of the constitution would be overturned, and that either the power of the crown or the power of the democracy would be unduly increased. His answer is an appeal to the idea of growth; as the numbers increased there would be the same proportions in the monarchical and democratic elements as before. The people on the other side of the Atlantic were afraid that owing to their distance from the seat of empire, they would not have the same real share in the Government, and that they would not be treated with the same consideration. The answer is that the colonial representatives would find it to their interest to bring before the Imperial Parliament any cases of malversation of authority in these distant places, and that their success as representatives would largely depend on their efficiency in pointing out and removing any causes of dissatisfaction of their constituents. And he goes on to say that the difficulty of distance would not be of very long duration, because with the growth of wealth and population "in little more than a century the seat of empire would naturally remove itself to that part of the empire which contributed most to the general defence and support of the whole." Nor must this idea of the transference of the seat of empire be regarded simply as the logical outcome of the scheme of a visionary. Adam Smith, first and last, is under the

domination not of imagination, but of facts; his ideals—large as they are—are raised within the limits of reality. He was well aware, from the history of the past, that the seat of empire might be transferred in response to changes in the distribution of power; and he based his anticipation of the superiority of the American colonies over the mother country in wealth and population on the relative progress already made, and on an appreciation of the wonderful natural resources of the North American continent.

And if any scheme of imperial union is to be successful in our century, we must also allow for the possibility that in little more than a century from the present day Canada may surpass the United Kingdom in wealth and numbers. And Canada is only one of the growing nations of the empire.

§ 5. *The Case of India.*

In dealing in his chapter on Colonies with the growth of empire and the organisation of imperial power, Adam Smith refers also to India. Here again, as already shown in the last chapter, his most severe condemnation is bestowed on the "shopkeeper" policy of the mercantilists. The greatest of economists asserts with vehemence that the government of the millions of India cannot be subordinated to the trade policy of the mercantile classes of Britain. The ruling country must take up the burden of government itself, and apply without fear the principles of justice to the dependency. It is matter

of history that the ideas emphasised by Adam Smith as regards the rule of subject races have been the guiding rules in the subsequent expansion of the British Empire over alien races. These ideas were by no means the creations of Adam Smith; in the phrase of to-day they were part of the subconsciousness of the nation, and were being called to the surface not only by Adam Smith but by all the great statesmen and thinkers of his time; they found the most exuberant expression in the rhetoric of Burke; they were embedded in the arid forms of Parliamentary bills. And, here again, whatever scheme of empire is adopted in our own day the difficulty of a growing India has to be faced; in this case not a mere growth of numbers, but a growth of ideas.

§ 6. *The Public Debts of the British Empire.*

So far the account of Adam Smith's imperialism has been taken for the most part from the chapter on Colonies;[1] it must be supplemented by the later chapter that forms the fitting climax to the whole argument of the *Wealth of Nations*.[2] This later chapter is entitled, "Of Public Debts." The real burdens of national debts, and their dangers, are exposed with arguments that have only lost their force through familiarity, and through the unparalleled growth in the taxpaying capacity of the nations of the world. It seems probable, judging from the rapid increase of public debts, that this old learning must be revived. In this place, however,

[1] Book IV. chap. vii. [2] Book V. chap. iii.

the ideas which most need extraction for present use are those which deal with the relations of public debts to imperialism. When Adam Smith wrote the growth of empire had meant the growth of debt; from his time to our own we find the same correlation. Adam Smith, as usual, faces the difficulties, and applies his principles with utmost candour. Since the debt has been incurred for the sake of the empire the constituent parts of the empire should contribute towards the payment of the interest and the extinction of the principal.

For this purpose, as well as for the expenses of imperial defence and of imperial administration, an additional revenue must be obtained by means of taxation from the rest of the Empire. Adam Smith accordingly goes on to consider what would be the effect of extending the British system of taxation to "Ireland and the plantations," and what modifications would be required.

§ 7. *The Union with Ireland.*

It must be remembered that Adam Smith was writing before the Union with Ireland (1800), of which, altogether apart from any wider imperial federation, he strongly approved. "By a union with Great Britain Ireland would gain, besides the freedom of trade, other advantages much more important, and which would more than compensate any increase of taxes that might accompany that union." These much greater advantages are to be found in the deliverance of the people of the country from the

rule of "an oppressive aristocracy founded on the most odious of all distinctions, those of religious and political prejudices, distinctions which more than any other animate both the insolence of the oppressors and the hatred and the indignation of the oppressed, and which commonly render the inhabitants of the same country more hostile to one another than those of different countries ever are. Without a union with Great Britain the inhabitants of Ireland are not likely for many ages to consider themselves one people." Those who wish to get at first hand the evidence which more than confirms this reference by Adam Smith to the ruling aristocracy of Ireland have only to read Arthur Young's *Tour in Ireland*, which, curiously enough, was begun just after the publication of the *Wealth of Nations*. Arthur Young's observations and records of the economic, political, religious, and social conditions of Ireland extend over a period of three years (1776-1779), and the book is one of the most fascinating ever written, though, until recently, strangely neglected in comparison with the other works by this most famous agriculturist.

§ 8. *Imperial Taxation and Representation.*

To return to the main argument: Adam Smith's scheme of imperial federation was intended to apply both to Ireland and the Colonies, and was to involve as a foundation the extension of the British system of taxation, so far as suitable throughout the whole empire. Such an extension, however, he thought,

"could perhaps scarcely be done consistently with the principles of the British constitution without admitting into the British Parliament, or, if you will, into the states-general of the British empire, a fair and equal representation of all those different provinces; that of each province bearing the same proportion to the produce of its taxes as the representation of Great Britain might bear to the produce of the taxes levied upon Great Britain." This is a repetition of the proposal in the chapter on Colonies, and it is to be observed that already he is forced to admit that the prejudices of great bodies of people impose obstacles which it is perhaps impossible to surmount.[1]

And to show still more clearly his appreciation of the difficulties, he continues:—

"Without pretending to determine whether such a union be practicable or impracticable, it may not, perhaps, be improper in a speculative work of this kind to consider how far the British system of taxation might be applicable to all the different provinces of the empire; what revenue might be expected from it if so applied; and in what manner a general union of this kind might be likely to affect the happiness and the prosperity of the different provinces comprehended within it.[2] Such a speculation can at worst be regarded but as a new Utopia, less amusing certainly, but no more useless and chimerical than the old."

[1] See above, § 4. Both quotations are from the first edition, which, however, was not published till 1776—the year of the American separation.

[2] This passage shows clearly that Adam Smith did not consider the question of empire, as is sometimes asserted, merely from the point of view of benefit to Britain.

It may be recalled that Adam Smith had already applied the term Utopian with much more emphasis to the possible establishment of free trade in the case of Great Britain; and his calculations of the imperial revenue are all founded on existing facts, and are by no means illustrations from hypothetical arithmetic.

§ 9. *Bases of Imperial Taxation.*

The four principal branches of British revenue were in his day the land-tax, the stamp duties, and the customs and excise duties. Each of these is examined from the point of view of use for imperial purposes.

At the moment the observations on the land-tax are of peculiar interest, and may be quoted at length. "If there were no tythe either in Great Britain or Ireland the landlords could afford to pay six or seven millions additional land-tax without being more burdened than a very great part of them are at present. America pays no tythe, and could, therefore, very well afford to pay a land-tax. The lands in America and the West Indies are, indeed, in general, not tenanted or leased out to farmers. They could not, therefore, be assessed according to any rent-roll. But neither were the lands of Great Britain in the 4th of William and Mary assessed according to any rent-roll, but according to a very loose and inaccurate estimation. The lands in America might be assessed in the same manner, or according to an equitable valuation, in consequence of an accurate survey like that which was lately made in the Milanese and in the dominions

of Austria, Prussia, and Sardinia." Adam Smith regarded taxes on land with special favour.[1] The stamp duties, he considered, might be levied without any variation in all colonies where the forms of law process, and the deeds by which property, both real and personal, is transferred are the same, or nearly the same.

"The extension of the customs-house laws of Great Britain to Ireland and the plantations, provided it was accompanied, as in justice it ought to be, with an extension of the freedom of trade, would be in the highest degree advantageous to both. . . . The British empire would thus afford within itself an immense internal market for every part of the produce of all its different provinces. So great an extension of market would soon compensate, both to Ireland and the plantations, all that they could suffer from the increase of the customs duties." [2]

The excise is the only part of the system which Adam Smith considered would present any real difficulties owing to the difference in the kinds of produce, and even the excise might be adapted with some modifications to the circumstances of the different provinces.

Having examined the application of the British system of taxation to the empire, he proceeds to calculate, on the existing yield in Britain, the probable imperial revenue. It is not necessary to go into these calculations, but the general results are worth notice. The aggregate imperial revenue would amount to

[1] Cf. *Wealth of Nations*, Book v. chap. ii. part ii. art. 1. See below, Chapter XVI. § 5.

[2] Cf. Chapter XVI. § 6.

sixteen and a quarter millions sterling, ten being furnished by Great Britain, as was the case at the time of writing. After deducting the expenses of government in the different provinces, it is shown that there would remain six and a quarter millions for the service of the debt in place of the one million which at the time was set aside for the purpose by Great Britain alone. The proportions to an age which loves percentages seem startling, but they show that Adam Smith intended his empire to be a real empire, united throughout for all the great requirements of empire, even including the payment of interest on the debt incurred in building up the empire and the parts thereof.

§ 9. *Summary of Leading Ideas.*

After this somewhat detailed account of Adam Smith's treatment of colonial and imperial policy it seems desirable to make a brief summary of the leading ideas. In the light of this summary we may then consider how the actual policy of this country towards the provinces has fallen short of Adam Smith's ideal (see Chapter XV.), and how far it is possible or desirable under present conditions to apply all or any of these constructive ideas to practice (see Chapter XVI.).

The first idea is that colonies and dependencies ought to contribute to the military power of the empire as a whole; also to the expense of the civil establishments that are equally necessary for the support of the empire; and to the interest on the

debt incurred in its development. This idea is in full accord with the first principles both of taxation and expenditure.

The first great rule of taxation is that the subjects of every state ought to contribute towards the support of the government as nearly as possible in proportion to their respective abilities, that is in proportion to the revenue which they respectively enjoy under the protection of the State. The subjects are compared to the joint tenants of a great estate—liable to a share in all the expenses of upkeep and acquisition.

Similarly the first claim on the revenue so raised is for the expense of defence. "The first duty of the sovereign, that of protecting the society from the violence and invasion of other independent societies, can be performed only by means of a military force."

The second of Adam Smith's leading ideas is that in return for, or in connection with, this contribution to the imperial revenue, the subjects of the provinces ought to have a share in the control of expenditure. Such control can only be exercised by some method of representation. The want of such representation was the cause of the ruin of the Roman organisation, whilst the development of representation in proportion to taxation is essential to the growth of the British Constitution.

The third leading idea is that the government of a great empire has other duties to perform besides providing for the protection and advancement of commerce. Mercantile profit is not always the measure

of national advantage; in some important cases they are opposed. The state is a bad trader; and the traders are bad statesmen, especially in the treatment of subject races.

The fourth idea is that the mother country cannot meet the expenses of empire from the indirect profit obtained from a monopoly of the trade of the colonies and dependencies.

It will be seen that of these fundamental ideas two are positive: the subjects must pay taxes and the taxpayers must be represented; two are negative; the state is not a business run for profit, and the state cannot get its revenue by the monopoly of trade.

Incidentally Adam Smith considers the alternative policy to this scheme for imperial federation; what may be called the method of friendly disintegration. Under this plan the parts of the empire would separate in a friendly manner with treaties of commerce mutually advantageous, each separate nation now providing for its own defence and administration. This method is rejected by Adam Smith as opposed to the fundamental sentiments at the root of nationality. The possibility is shown in our own times by the political severance of Norway and Sweden; but there can be no question that since the time of Adam Smith the tendency has been to an increasing extent towards closer amalgamation of loosely connected States; and great wars have been undertaken to prevent disintegration—witness the civil wars in the United States of America and in South Africa.

CHAPTER XV

BRITISH COLONIAL POLICY SINCE ADAM SMITH

§ 1. *Different Ideas of Colonial Policy.*

THE separation of the thirteen American states from the mother country, and the recognition of their Independence, naturally led to a change in British colonial policy. In the brief survey attempted in this chapter, an effort will be made to indicate the leading ideas that have brought about the present situation. To begin with, the fear of losing other colonies, especially Canada, led the Government to try to keep the colonies more under control as regards the management of their internal affairs. This was the first idea — more management, and more careful management. It was believed that the chief cause of the revolt of the thirteen states had been the growth of the sentiment of independence in consequence of the absence of effectual home control.

The second idea was that the individual colonies were to be carefully watched, and in some cases to be isolated, and weakened politically, so as to prevent any dangerous federation. Pitt, for example, in introducing the Quebec Bill of 1791, said that the

object was to create two colonies in Canada, separate and jealous of each other, so as to guard against the repetition of the American example in which the thirteen colonies had, or thought they had, the same interests. Both of these ideas have not only been abandoned but reversed; devolution and federation have ousted altogether the ideas of management and jealousy. The history of the change is instructive.

In order to carry out this policy of internal control, various officials had to be appointed directly by the Colonial Office (which in 1794 had been revived for the purpose); great abuses naturally sprang up in the patronage; and the colonies were shamelessly exploited for the benefit of place-hunters in the home country. In the Crown colonies the dominion of the Crown (*i.e.* of its advisers) was absolute, and the authority of the Colonial Office was exercised directly by instructions to the governors. The management from Downing Street aimed at omniscience and omnipresence. In the free colonies the home control was exercised for the most part indirectly through the influence of the governors and their councils. "Self-government was there in theory; but in practice the governors, aided by dominant interests in the colonies, contrived to govern according to the policy dictated from Downing Street."[1]

[1] Erskine May's *Constitutional History of England*, vol. iii. chap. xvii. p. 361. *Ibid.* for the abuses connected with patronage.

§ 2. *Growth of Self-Government—Preferential Duties.*

The irritation caused by these abuses of management from Downing Street, naturally led the colonists to demand, and the progressive party in England to support, an extension of self-government.

With successive grants of self-government, by way of counteracting the tendency to independence an endeavour was made to bind the colonies by commercial ties. Mindful of the evil results of the restrictions imposed under the old monopoly, attention was directed to the development of the old system of bounties and preferential duties on exports of colonial produce to this country. Intercolonial trade was also managed from the same point of view—namely, the commercial nexus as the bond of empire. The West Indies, for example, instead of being allowed to develop their natural trade with the United States, were compelled to take, at high prices, the produce of Canada, which sometimes could not give enough.[1] But the bribe to Canada irritated the islands. The preferences given to the colonies in British markets were defended as a sort of compensation for the political restraints imposed.

Unfortunately, however, the people of this country began to realise or to imagine (which in politics has often the same result) that the colonial preferences imposed burdens solely on them,[2] and gave benefits

[1] Davidson, *Commercial Federation and Colonial Trade Policy*, p. 11.

[2] Davidson, p. 14 n. In 1840 it was calculated that England lost from £5,500,000 to £8,000,000 per annum by dearer goods, besides losing in the quality, notably in the case of timber.

solely to the colonists. It is true that, nominally, this country had similar advantages in the colonial markets as against the foreigner, but, as a matter of fact, England at the time practically had a monopoly owing to being the first to take advantage of the industrial revolution in manufactures, and there was no need of restrictions.

Naturally, then, such being the popular idea of the working of this preference-and-control system, people in this country began to ask wherein lay the benefit of colonies to the mother country? This was a very old question, going back, as Dr. Cunningham has so well shown, to the very beginnings of colonies[1] in the seventeenth century.

The colonies also, in spite of the preferences, saw that in some cases they might gain more by trade with other countries, notably the United States. Accordingly the attempt to bind together the home country and the colonies by a system of commercial preferences and political restrictions had the opposite effect to what was intended; it created mutual jealousies between the various parts of the empire. The reciprocity was, in Davidson's phrase, a reciprocity of disadvantage. And this constant looking to trade and commercial connections as the true basis of union rather tended to stifle than to enkindle other sentiments.[2]

Recently attempts have been made to show that the preferential system had its advantages, and that

[1] Cunningham, vol. ii. p. 333.

[2] Cf. Davidson, pp. 51-52 n., for summary of the history of the preferential duties.

its abandonment was resented by the colonies; but, at any rate, the fact remains that by 1854 the system had been practically given up, and the last vestige, the preference on timber, disappeared in 1860.

§ 3. *View of present Position of Imperial Union: a Contrast.*

This complete abandonment of the colonial preferences, which in theory had been a sort of compensation for the political control by the mother country, naturally led to a still further development of self-government in the case of the free colonies. And, as a consequence, at the present day we are left, so far as they are concerned, with the "minimum of empire," or, conversely, they are practically independent. Especially is this the case with regard to the organisation for defence, which by Adam Smith is placed first in the requirements of a real, as distinct from an imaginary or nominal empire.

When Adam Smith wrote, it was a matter of general belief that the home country, in return for undertaking alone the expense of defence, obtained, in some way or other, an equivalent in the monopoly of trade. And certainly the monopoly was sufficiently exclusive, even if less exclusive than that of other colonising nations; and the monopoly embraced India as well as the British colonies. Adam Smith, indeed, maintained that the gain to the country by this monopoly was illusory; but the general opinion was exactly the opposite; and the people of the mother country, at any rate, believed that, in return

for their sacrifices in blood and treasure, they had a veritable gold mine in the monopoly of trade.

§ 4. "*Not an Empire but the Project of an Empire.*"

But when we look to the present position, we find that every shred of this monopoly of trade has vanished; so that as a nation we have not even the consolation of this doubtful privilege. "This empire," said Adam Smith, "has hitherto existed in imagination only. It has hitherto been not an empire, but the project of an empire." It has been only a "golden dream." Judged by the tests which he was bold enough to apply, our present empire, in like words, must be called a dream within a dream.

In the course of little more than half a century, the free colonies have, in effect, become free nations, under a nominal sovereignty; we have adopted the old Greek plan, without even providing for freedom of commerce—a scheme of empire which was rejected by Adam Smith, even with the provision of commercial treaties which were supposed to endure for centuries. Fortunately, we have succeeded in proportion as we have relaxed the ties of empire in strengthening the bonds of affection; and above all, the self-governing colonies have followed the mother country in political freedom, and the crown colonies and dependencies, if governed by this country, are governed for the benefit of the respective peoples. And yet, if from the point of view of organised military power the British empire, in the words of Adam

Smith, is still only "a golden dream," from the point of view of the civilisation of the world it has been, and remains one of the greatest realities in progress.

At the same time, it must be admitted that neither the statesmen nor the peoples of the most civilised countries have yet come within sight of the acceptance of a cosmopolitan political ideal, which shall subordinate the interests of the nation to the interests of civilisation in general. As with Adam Smith, so now, home is the centre of political attraction, and the unit of civilisation is still the independent political society. The long continuance of the horrors of the Congo, and of similar, if lesser, barbarities in different parts of the world, is proof sufficient of the overwhelming domination of national compared with cosmopolitan sentiment. And, again to quote Adam Smith, our love of country is not derived from our love of mankind in general.

§ 5. *What at present are the National Advantages of Empire?*

If, then, still taking up the national standpoint, we ask, as Adam Smith asked, What are the special national advantages which we as a nation derive from our extended empire, if we separate, as he did, the cosmopolitan from the peculiar national advantages, the answer is the old answer that there are no actual advantages, but only possibilities of advantage.

What are the national economic advantages, apart from the increase of military force or revenue, which, under modern conditions, might be expected to be

obtained by the mother country from the extension of empire? There is, first of all, a wider field for the settlement and employment of the people of the country. Every old country from the beginnings of history has felt the need of finding room for an expanding population.

At the present time Germany feels a pressing need for the expansion of her overseas dominion in view of the growth of population. The territorial expansion of the British empire, on the other hand, has been so rapid and extensive that we have reached the point of satiety.

But although we have apparently provided an unlimited field for the emigration of our surplus population, we have taken no pains to put the surplus labourers into that field; we have left them to overcrowd our own cities, or to seek new homes in foreign states, as their ignorance or inclination directed. "From 1853 to 1898 the total emigration of persons of British or Irish origin was 8,549,569 persons, of whom, 5,690,712 went to the United States." Conversely, the people of other nationalities are welcomed to our colonies, and recently, for example, the immigration into Canada of foreigners (including those from the United States) has far exceeded that from the United Kingdom. It is also said that the emigrants to Canada from Europe have, for the most part, a lower standard of comfort than the British, and as a consequence they are much more quickly in a position to be able to equip land and to become the real owners of land out of their savings.

The question of emigration and immigration is, no doubt, complex and full of difficulty. In the past England gained much from alien immigrants, and it is possible that the empire may gain under modern conditions in the same way; but it is hardly probable that haphazard emigration from the United Kingdom and haphazard immigration into the rest of the empire will produce the maximum of benefit either to the home country or the empire. For fifty years after Adam Smith wrote the emigration of the skilled workman to a foreign state was criminal, both on the part of the artisan himself and of the provocative agent. Already, it is true, we have been forced by glaring evils to begin the elements of organisation in the classification of immigrants and the exclusion of certain classes. But we are far from any idea of the systematic organisation of what may be termed intermigration between the different parts of the empire. To all intents and purposes, what we are pleased to call the British empire is equally open to the surplus (white) population of all other countries.

Secondly, as with the living capital, the most valuable part of the capital of the nation (even if the value is reckoned strictly in terms of money), so with the dead capital. Like the wind it goes whither it lists. It is true that large masses of British capital have been invested within the limits of the empire, but also masses of capital have been sent elsewhere. Here, again, no doubt, the question is complex; under certain conditions there are advantages in the permanent investment of British capital in foreign

countries; but, other things being equal (or what is the same thing, the special conditions being absent), in general the employment of capital within a country is more advantageous to its people than if it is employed out of the country. The advantage of the employment is not to be measured merely by the profit; we must look to its continuous use and continuous reproduction. And so far what is true of a country is true of an extended empire. Railways, for example, made by British capital in the United States may yield greater profit than similar railways in Canada or South Africa, but the advantage to the empire is very different.

Thirdly, as regards foreign trade, following Adam Smith, all foreign trade means to some extent the employment of capital out of the country, and so far is less advantageous than home trade. But, under certain conditions there are advantages that more than compensate this export of capital; and in old countries that have long been wealthy, there is generally a surplus of capital that cannot be employed in home trade. On Adam Smith's principles, trade within the empire, other things being equal, is more advantageous to the empire than external trade. Even in the case of friendly disintegration he assumed that provision would be made for free trade between the different states. Under present conditions, however, the trade of the United Kingdom with foreign countries is about three times the magnitude of its trade with the British possessions; and although the trade of the possessions with foreign states is on

the whole much less than with the United Kingdom, this distribution in our favour can be accounted for, only to a small extent, by the nominal imperial connection.

Apart from the recent grant by the colonies of preferences to British exports for the most part in the shape of a super-tax on foreign goods, the home country has no special advantage over foreign nations in trading with British possessions.

Accordingly, we are forced to the conclusion that as regards national, as distinguished from a share in cosmopolitan, advantages, whether we look to military and naval power, or to the employment of our labour and capital, we have "not an empire but the project of an empire."

Accordingly, the most pressing political question of the day is whether the time has not arrived when, especially from the point of view of defence, the potentialities of empire must be turned into actualities. To the world at large the wide extension of the *pax Britannica* is no doubt an immense boon, but, if opportunity offered, in the present as in the past, the nations of the world would share in the partition of the British possessions as readily as in the partition of China. If our empire is to be preserved under modern conditions, the power of the sea must be upheld, not merely by the United Kingdom but by the United Empire. That is the first essential requisite; and if this is attained the way is prepared for a closer union for other political and social requirements.

CHAPTER XVI

CONCLUSION

§ 1. *British Command of the Sea needs Colonial Co-operation.*

THE growth of the naval power of foreign states—especially of those which in military power are already immensely superior to the United Kingdom—will make it impossible, in the course of a very few years, for this country alone to secure the maintenance of the empire by the supreme command of the sea. The British command of the sea can only be retained with the effective aid of the colonies. The need for effective colonial aid for the maintenance of naval power is urgent and pressing; it cannot be met by promises which will require a long period for their fulfilment; nor merely by the adoption of means designed to advance the general prosperity of the constituent parts of the empire. In times of commercial crisis it is of no avail for a bank to have excellent permanent investments if it cannot meet immediate requirements; and in case of war no ultimate reserves of wealth and numbers will suffice to build and man ships, and to train and equip armies in time for active service.

§ 2. *Present and Future Need for Co-operation.*

The aid that is required is not simply to meet an unforeseen and temporary emergency not likely to recur; the need for aid is not only pressing, but it is a permanent and growing need; and the aid from the colonies to be effective must be aid in proportion to their wealth and population, and must grow with their growth.

In the last resort, therefore, such aid—adequate aid—can only be afforded, whatever form it may take and whatever the conditions of control adopted, by the consent of the colonies to the imposition of new taxation for the purpose. The continuous expense of defence can only be met from a continuous revenue. How, then, is this consent to be obtained? What reasons are to be brought to bear on the colonial democracies to induce them to take up this new burden?

It needs no showing that the aid of the colonies must be voluntary. In all the essential elements affecting their economic interests the self-governing colonies are practically independent nations. They can impose what taxes they please—even protective duties against the mother country—and they can make any experiments they choose in industrial legislation. They have full command over their lands, labour, and capital. For this country to insist on the payment of "ship-money" would be more likely, as in the past, to arouse civil war than to further national defence.

§ 3. *Defence a Primary Duty for every Nation.*

It may, perhaps, be thought that this insistence on the *de facto* national independence of the self-governing colonies is fatal to the request for aid for imperial defence. The cause generally assigned by recent writers for the revolt and final separation of the thirteen American colonies is the growth of the idea of nationality; and the immediate occasion of the revolt was the attempt to raise revenue ostensibly for imperial defence. How, then, shall we venture to propose to the present colonies similar contributions for similar purposes?

The answer is that the recognition of the idea of nationality carries with it the recognition of the primary duty of defence.

Let it be supposed that the ultimate goal of Canada, Australia, New Zealand, and South Africa is in each case national independence; and that through fear of imperilling this issue they refuse to contribute a proportionate share to imperial defence. The only possible alternative is that they themselves must provide for their own defence, and for the enforcement of their rights and privileges against foreign powers. If, then, the colonies recognise this primary national duty there can be no question that they must also provide an effective naval force. They must follow the example of the United States in defence if they elect to follow that example in independence. With the best of good will the United Kingdom cannot undertake for the future to keep up

alone the sea power of the empire; and if the empire is broken up, and for nominal sovereignty an alliance is substituted, the other allies must bear their share.

The point is that whatever the degree of national independence claimed for the colonies, the time has come when each and all must consent to provide a revenue for maritime defence.

If Canada, for example, in the future becomes an independent nation or joins the United States, she must, in either case, contribute to the maintenance of naval power; and if she elects to remain an effective part of the British Empire this obligation is in no way diminished.

§ 4. *Imperial Co-operation most Efficient and Economical.*

Fortunately, with the growth of freedom and self-government, there has been also a growth of imperial as well as of national sentiment, and at present there is no question either of breaking away from the United Kingdom or of amalgamation with foreign states.

And it is easy to see from general considerations that the local defence of the seaboard of the colonies will be best promoted by a close organisation with the British navy.

If the self-governing colonies accept the principle that they ought to contribute in proportion to their wealth and population to the naval defence of the Empire, if they are willing to provide an adequate revenue for the purpose, they would no doubt desire

that the most effective use possible should be made of their contributions.

If each colony aims, in the first place, at securing only its own local defence, or the trade routes in which it is most concerned, if it insists that its own contributions shall be spent entirely under its own control, there will be a loss of economy and a loss of efficiency. The solution suggested in Adam Smith's scheme of imperial federation is found in the principle of representation. He uses the term "the States general" of the empire, but it is not essential to the principle that it should take that form. What is needed is that each colony should in some way have a share in the control and the management of imperial defence. And as an ideal this plan seems much to be preferred to the adjustment of local expenditure to local needs. Defence is eminently a duty of the central government, and in any real empire there must be some such central authority.

It is also obvious that if the colonies contribute to an imperial navy they must have a voice in the uses to which it shall be put. But this can only mean that they have a voice in the appointment of the central authority which must decide on peace and war, and on the questions on which the issue depends.

At the same time, we are warned by history, and by the actual growth of institutions, that the approach to an ideal must be made by tentative steps. Adam Smith was no advocate of systems meant to be established by sudden revolutions. He looked on colonial

representation as the natural development of the British constitution. And, applying his methods and ideas, there is no reason why the colonies should not begin, in the matter of their contributions to the naval force of the empire, by making provision for local needs and special trade routes. On this plan they would follow the lines of historical development. If we go far enough back we find that in England, not only particular localities, but even particular traders, and in some cases particular bishops, made their own contributions of ships of war for the protection of property and trade.[1]

Those who prefer modern science to ancient history for the suggestion and clarification of ideas, may be referred to the laws of biological development; the highest organism in its embryonic stages goes through all the forms of previous existence, the only difference being that the changes of centuries are compressed into hours or moments. If the colonies begin with the methods of the Saxon period we may be sure they will rush over the intervening centuries, if only they know, consciously or unconsciously, the final type to which they ought to move.

§ 5. *Sources of Revenue for Imperial Defence.*

If the colonies undertake to make continuous contributions to the naval forces of the empire, it

[1] See Stubbs's *Constitutional History*, vol. i. pp. 105, 117, 593. In Saxon times each shire was bound to furnish ships in proportion to its number of hundreds; the shire was in origin an under-kingdom, and in the twelfth century the ships of different localities sailed under their own local magnates as captains.

may seem ungracious even to indicate the sources from which they may obtain the necessary revenue, especially in view of the fact that each lays much stress on fiscal autonomy.

But what might seem impertinence from the practical politician becomes an interesting speculation in the words of a prophet dead more than a hundred years. Of the modes of raising revenue for defence suggested by Adam Smith as capable of being applied throughout the empire, two are of special interest at the present time, namely, the land-taxes and the customs duties. They are also in this connection of special historical interest. In Saxon times the provision of ships was a recognised burden on land; *e.g.* in 1008 Ethelred ordered that a ship should be furnished by every three hundred hides,[1] and we read of a grant of land being made (to a bishop), subject to the provision of a fully equipped ship.

There is nothing new under the sun; all taxes are old, and it is only the amounts which vary; the unearned increment from land was discovered, named (*incrementum*), and taxed in the mediæval period.[2] Modern ideas of taxation of land values are all found in the *Wealth of Nations*.

"Ground rent and the ordinary rent of land are, therefore, perhaps, the species of revenue which can

[1] The hide is supposed to be land for one freeman, normally 240 acres.

[2] "When a county was let out at ferm for more than it was formerly wont to be let for, the improvement, or advance money, was usually called *Crementum*, the increment" (Madox, *Exchequer*, p. 225). In Magna Charta clause 25 provides that counties, etc., shall be let out at the old rents without any increment (*ad antiquas firmas absque ullo incremento*); and it is significant that in subsequent confirmations this clause was omitted.

best bear to have a peculiar tax imposed upon them."[1]

Adam Smith observed that in his day, had it not been for the tithe the landlords could have paid much more land-tax, and "America pays no tithe, and could, therefore, very well afford to pay a land-tax." It is not necessary to go over ground so well "eared" already, but if we take the usual estimates that at present the self-governing colonies have a population of some thirteen millions, and that in a century this will exceed one hundred millions, and if we assume that site values grow with wealth and population in new countries, this source of revenue seems admirably fitted for meeting the growing needs of defence.

The other principal source of revenue on which Adam Smith would rely for contributions from each part of the empire is the customs revenue. Here again the historical origin is interesting as bearing on present-day proposals. "The duties of customs appear to have been originally considered as taxes on the profits of merchants. . . . The gains of alien merchants were looked upon more unfavourably than those of English merchants. It was natural, therefore, that those of the former should be taxed more heavily than those of the latter." "In those ignorant times it was not understood that the profits of merchants are a subject not taxable directly; or that

[1] The whole of Adam Smith's treatment of taxation of land is of special interest at the present time. He shows that improvements ought not to be taxed; approves, and gives examples of national valuation of lands, and observes that "it is not very unreasonable that the rich should contribute to the public expense, not only in proportion to their revenue, but something more than in that proportion."—Book v. chap. ii. art. 1.

the final payment of all such taxes must fall with a considerable overcharge upon the consumers."[1]

The further examination of the customs duties as a source of imperial revenue for imperial purposes may be deferred until after the consideration of internal free trade (*i.e.* within the limits of the empire) and the commercial relations of the empire to foreign states. One more reference, however, may be made to general principles. The method of assigning particular revenues to particular expenses which was at first universal has in general been for the most part abandoned. In a period of transition, however, such a method may be useful as being of a more simple type. That a colony should vote so many millions a year from its general revenues for defence against what many might think unreal dangers, might seem an absurd suggestion, but it seems not unreasonable that it should assign a certain share of a growing revenue to new needs. In matters of imperial defence, as so often observed, a century may be a short period.

§ 6. *Free Trade within the Empire.*

If we take a broad view of Adam Smith's ideas on the conditions necessary to convert the project of an empire into a real empire, next in importance to the recognition by the colonies of the duty of defence, must be placed the establishment of free trade within the limits of the empire. Here we must carefully distinguish between such internal free trade and free trade with

[1] Book v. chap. ii. art. 4.

foreign nations; the two questions are quite distinct and are best considered separately, as is obvious by a reference to actual instances of the policy of nations. The United States, for example, has adopted against the rest of the world a protectionist system; but from the beginning free trade between the constituent states was provided for by the constitution.[1] Alexander Hamilton was as strong an advocate of internal free trade as of external protection. And in the same way internal trade between the different states of the German empire is combined with protection against foreign countries; and here again List was as much in favour of the first as of the second condition.

As already shown, Adam Smith was of opinion that the separation of the colonies on friendly terms (as in the Grecian model) might not be disadvantageous to the mother country if—and the condition is essential—if the separation were made with the provision of commercial treaties "which might endure for centuries together" for the establishment of free trade between the parts; that is to say, political disintegration with alliance for defence and open markets for trade.

And in the real federation of which he himself approved one of the essential conditions is that the whole empire should form one great internal market. "The trade between all the different parts of the British empire would, in consequence of the uniformity in the custom-house laws, be as free as

[1] See below, § 9.

the coasting trade of Great Britain is at present. The British empire would thus afford within itself an immense internal market for every part of the produce of all its different provinces." Then follows a remarkable sentence which has an important bearing *mutatis mutandis* on present issues. "So great an extension of the market would soon compensate, both to Ireland and the plantations, all that they could suffer from the increase of the duties of customs."

§ 7. *Advantages of Internal Free Trade.*

The whole range of economic history shows that national progress has always been associated with the development of internal free trade. In mediæval England, for example, every town protected itself against every other, and one of the principal characteristics of the transition from the mediæval to the modern period was the break-up of these "ancient customs" and the substitution of national for local regulation of trade. "The fifteenth and sixteenth centuries saw the rise of nationalities not only in a political but in an economic sense as well; since industry and commerce were beginning to be organised for national objects and on a national basis. The town no longer held its position as the chief organ of economic life."[1]

As regards the advantages of internal free trade to the empire as a whole the appeal to experience ought to suffice. Consider the United Kingdom, Germany, the United States, France, Italy, and it is plain that

[1] Cunningham, *Growth of English Industry and Commerce*, vol. ii. p. 5.

in every case the adoption of internal free trade between the different states or provinces or under-kingdoms was essential to the completion of national unity.

Both the United Kingdom and the colonies would suffer certain inconveniences as regards revenue, from the necessary alteration of their customs duties which at present, to a considerable extent, fall on the products of different parts of the empire; but there can be little doubt that the necessary revenue could be raised in other ways; and customs for revenue might be retained so long as necessary. The real difficulty is encountered when we look at the question from the standpoint of the protectionist colonies; the real difficulty is not revenue but protection. And if these difficulties are to be overcome,[1] the advantages must be made clear.

In the first place, then, the very idea of such internal free trade is that capital and labour would flow where most required. And there can be no doubt that the flow in both cases would be from the mother country to the colonies. It is also equally clear that the great object of all the colonies is to attract labour and capital.

The interests of the colonies in this matter of internal free trade may be examined from the point of view of the history of the United States and in reference to the arguments advanced by Alexander Hamilton. The question may be put in this form: If it was an advantage to the American colonies in

[1] See next section.

the time of Hamilton to adopt protectionist duties against Europe and especially against England, why should it not be equally advantageous for Canada which economically is at an early stage of development to adopt a similar policy?

It must again be pointed out that at present the question is not as to the complete abandonment of differential duties, but only of such as fall on British goods. The case of imperial protection against the world is considered later on.

With this proviso it will be apparent to any reader of Hamilton's report that his great arguments do not apply to the case of Canada and the United Kingdom; and Canada is only taken as representative of all the protectionist colonies.

The opening sentence of Hamilton's *Report on Manufactures* states that his attention had been directed "particularly to the means of promoting such manufactures as will tend to render the United States independent on foreign nations for military and other essential supplies." Amongst these essential supplies are all kinds of manufactures; and he goes on to show, in the first place, that the markets of Europe were not regularly open to the agricultural products of the States; and accordingly there was a difficulty in obtaining the corresponding imports from Europe when barriers were imposed on the exports from the States. It is obvious that if Canada is regarded politically and economically as part of the British empire, military dependence on the mother country for supplies is totally different

from dependence on foreign nations; and the markets of England are, and have been for years, open to colonial products.

Hamilton's second argument is that it was desirable to foster manufactures in the states so as to give an encouragement to agriculture. Here again there can be little doubt that the agricultural interests of Canada (and other colonies) are prejudiced by the protectionist duties imposed against British manufactures.

Thirdly, there is the argument that for a new country it is necessary to promote artificially the growth of towns and cities in order to obtain a variety of industries and other social advantages. This argument may be answered by reference to the development of the United States. Internal free trade over these vast territories, even before the recent development of the means of transport, did not prevent the growth of cities in the newest and most distant States; towns and cities were not confined to the old Eastern states, nor were the newer states devoted entirely to agriculture. And in the same way it may be supposed that the growth of towns and cities in the British dominions would not be prejudiced by internal free trade. One of the best founded inductions of commercial geography is that the growth of towns and cities depends mainly not on manufactures but on trade.

Let the statesman of any self-governing dominion consider the question from the point of view, not of particular manufactures, but from that of the whole

industry of his dominion, and, even with this narrow view of colonial interests in which no regard is paid to the rest of the empire, he will discover that free trade with the United Kingdom is an object worth striving for; because the gain to agriculture and the gain to trade would more than compensate the temporary loss from the partial decline of certain protected manufactures.

But the question must be regarded from a higher standpoint. Internal free trade means, indeed, in the first place only the breaking down of fiscal barriers and obstacles within the empire; but it is also a necessary preliminary to the full development of all kinds of improvements in the means of communication and transport (in Adam Smith's words, endorsed by Hamilton, "the greatest of all improvements"), so that not only material goods, but men and ideas may be readily transferred from one part of the empire to another. Internal free trade, with the development in a multitude of forms of closer union between the different parts of the empire, is closely connected with imperial defence. Under modern conditions defence depends, in the last resort, more than ever on wealth and population, and we may add organisation. "In ancient times," observes Adam Smith at the conclusion of his remarkable chapter on the expense of defence,[1] "the opulent and civilised found it difficult to defend themselves against the poor and barbarous nations. In modern times the poor and barbarous find it difficult to defend themselves against the

[1] Book v. chap. i. part i.

opulent and civilised. The invention of firearms, an invention which at first sight appears to be so pernicious, is certainly favourable to the permanency and extension of civilisation." And since Adam Smith wrote this argument has increased in force at an increasing rate; witness the expense of a single big gun, a single battleship, or a single railway for strategic purposes; or consider in gross the enormous military expenditure of every civilised state. If we wish to compare the real military power of modern nations, *e.g.* Russia, France, and Germany, we have to take account of their wealth and population, and also of the internal organisation by which this potential power of numbers and wealth may be brought to bear on military needs. If the colonies are in earnest in wishing to co-operate in making the defence of the empire absolutely secure, they must realise that in modern times national or imperial power is increased by everything that increases the numbers and wealth of the empire as a whole, and by everything that unites more closely the various parts.

Apart from the consideration of defence, there are other objects of political union which can be most effectively achieved on a large scale. The resources which are the ultimate reserves of military power are also the resources from which must be met the growing social needs of the community. The rise in the standard of life and the standard of comfort of the masses of the people is only possible with a continuous increase in the productive powers of the society. The most efficient cause of the prosperity of

new colonies, as shown by Adam Smith on a wide inductive survey, is the capital, living and dead, which they acquire from the old civilisations. If the United Kingdom has much to gain from the development of the natural resources of the colonies, the colonies have much to gain from the accumulations, material and immaterial, of the old country.

§. 8. *Difficulties in the Establishment of Internal Free Trade—how met.*

In the light of history it would be foolish to deny that the sudden abolition of all protective duties now imposed by the British dominions against British goods might be inconvenient to certain classes and industries and localities.

If, however, the real advantages of internal free trade are once appreciated by the statesmen and the people of the dominions, these difficulties are not insuperable.

The most formidable are not founded on facts but on opinions, and opinions may be changed. In the forefront there is the idea of impossibility; and so long as statesmen are content to repeat, one after the other, that a thing is impossible, it is *ipso facto* impossible. It will cease to be impossible as soon as it seizes the imagination of a great colonial leader of the order that believes in a thing because it is impossible. Every great success in war and in peace has been impossible until it has been accomplished. In the background there are the prejudices of the people; but though the race continues, the

individuals change and the prejudices change with them.

These are, no doubt, commonplace generalities, but they are sufficient to clear the way for practical considerations of a more detailed kind.

The difficulties, once they are faced, may be met by a variety of methods, some of which are being tried for other purposes at the present time.

In the first place, we may apply Adam Smith's idea that the freedom of trade should be only restored by slow gradations. The precise nature of the gradations must be left to the practical man; but some of the possible ideas to be applied may be noticed.

Internal free trade, as already insisted, does not necessarily mean either now, or in the future, external free trade with foreign states. From the point of view of gradations this distinction may be of importance. Already some of the colonies have granted preferences to the mother country by the simple plan of putting supertaxes on foreign goods; and a further reduction of the duties on British goods might be accompanied, in the period of transition, by a corresponding supertax on the foreign.

If the idea of internal free trade is accepted the real difficulty is with the vested interests. And these vested interests ought to be reduced to their true dimensions in equity, before compensation, direct or indirect, is provided. "There is no prescription of institutions"; the utmost that is required is the adequate compensation to the vested interests of

individuals. And what constitutes adequate or equitable compensation varies indefinitely according to the circumstances of the case; it ranges in practice from the *pretium affectionis* above the mere market value given to hereditary landowners (with John Stuart Mill's approval) down to the cancelment of arrears of rent or interest or debts, without any compensation whatever. From the economic point of view—in which the principal consideration is the possible shock to security through interference without compensation—there is no doubt that compensation to vested interests has been carried to an unjustified extreme. In the progress of society security must be sacrificed to security in Bentham's phrase; and it is only by such sacrifices that any social improvements have been accomplished; *e.g.* in the laws of bankruptcy and the laws affecting the tenure of land.

In some cases it seems sufficient to give a reasonable intimation of the impending change; and sometimes people may be expected to notice for themselves the growing changes in public opinion which are likely to be expressed in interference with private interests. A limit of time might be indicated for the coming of age of the infant industries, and in the meantime a stop might be put to the creation of new differential duties within the empire. Certainly it has never been admitted that the permanence of protective duties ought to be considered one of the reasonable expectations implied in industrial contracts; and in fact the favourite argument in support of such

duties in new countries is that they are essentially temporary, and for the benefit of infant industries only.

If in an old country such as England a complete abolition of a complicated mass of protective duties could be accomplished in the course of a very few years, it seems absurd to suppose that in new countries which show themselves ready to undertake all sorts of social experiments, especially in the interests of labour, the one task which they dare not attempt should be the abolition of protective duties. In general, in any interference with vested interests, it is only the owners of property that have received compensation, but Adam Smith's main reason for the *gradual* abolition of protective duties was that labour might not be suddenly thrown out of employment. If this difficulty were carefully examined and fairly met, there seems no reason why the labour parties in the colonies should oppose free trade with the United Kingdom. We are often reminded of the solidarity of labour, and in this country the labour leaders are in favour of free trade even with foreign countries. Free trade within the empire would promote the establishment of labour exchanges between the United Kingdom and the dominions, and the increase in the mobility of labour would increase the total revenue available for labour.

§ 9. *The Method of Preferential Duties.*

The method, so much favoured at present, of purchasing freedom of trade with the colonies by

preferential duties on their products (*i.e.* by taxes on foreign goods of similar character) does not get over the difficulty of the divergence of class interests. The United Kingdom must give preferences for the most part on agricultural products if they are to be of any advantage to the colonies. Whatever method of compensation is adopted taxes on ordinary foodstuffs would be unpopular in this country with a very large number of people. And in a matter of union sentiment is of the first importance. The people in the colonies who would benefit are the agricultural classes, who are confessedly in no need at present of any such aid. The bargain so far would have the appearance of giving a bounty to the thriving farmers of the colonies to be paid for out of the necessities of the poor in the old country. It may be proved by experts to the satisfaction of statisticians that there would be no real injury to the poor, but the sentiment would not be disposed of so readily.

Those who would gain in the first place from the preferences granted by the colonies are the manufacturers of this country, at the expense ostensibly of the manufacturers in the dominions overseas. The extent of the gain and the loss would depend on the nature and degree of the preferences. If they are only supertaxes on foreign goods, the rates against Britain being practically the same as before, the main result will be a substitution of a certain amount of British imports for foreign, and the colonial manufacturers will not suffer. But by preferences of this kind no real advance is made towards free trade within the empire.

The root idea in this policy would be the protection against the foreigner by the empire (the United Kingdom included), rather than the gradual development of free trade within the empire. The system of preferences by the method of supertaxes must be regarded as a substitute for free trade within the empire, instead of being a method by which it may be promoted. Judging by experience, preferential protection of this kind, like other forms of protection, would tend to be permanent owing to the creation of vested interests, and possibly to increase owing to the political power usually exercised by protected interests.

There is no getting over the difficulty that the adoption of free trade within the empire must mean the disturbance of vested interests in the colonies. If the policy is to be decided by a conflict of classes, the colonial agriculturists have more to gain by free trade with the United Kingdom than by any system of supertaxes on foreign manufactures. A conflict of classes is not a good beginning for union, but it may be necessary.

If the ideal of internal free trade is accepted it might no doubt be approached by the method of preferences if they take the form of a gradual and continuous reduction in the duties imposed on British goods, supertaxes on foreign goods being only used as a temporary method of adjustment.

In the last resort, however, if free trade within the empire is to be attained it must be by the realisation that such internal free trade is a fundamental condi-

tion of any real imperial union. Here, as already insisted, the history of all the great civilised countries is conclusive. The colonies without any bribe, or any careful weighing of the class interests affected, recognised the duty of sharing in the naval defence of the empire as soon as the need was realised. Their statesmen repudiated with indignation the idea that their contributions would depend on the grant of commercial favours. If in the same way they can be brought to see that free trade throughout the empire is one of the best methods of securing closer union, greater community of interests, and greater wealth and power to the empire as a whole, it may be expected that they will follow the example of other great states, and consent to this partial abandonment of national sovereign rights.[1] The adoption of free

[1] The advantages of internal free trade as the basis of imperial union, and the difficulties to be overcome in the attainment, are well shown in the history of the United States after the recognition of independence by Britain by the treaty of 1783. The point has been admirably brought out in Mr. Oliver's *Life of Hamilton*. One of Hamilton's chief difficulties was to get rid of the sovereignty ideas of the particular states in matters of trade. "Power, prosperity, and consideration, which all men affected to desire, were only to be had on terms which the states could not bring themselves to pay. . . . The thirteen states proceeded to indulge themselves in the costly luxury of an internecine tariff war. The states with seaports preyed upon their land-locked brethren, and provoked a boycott in return. It was a dangerous game, ruinous in itself, and behind the custom-house officers men were beginning to furbish up the locks of their muskets" (*Alexander Hamilton*, p. 134, by F. S. Oliver).

The necessity for vesting the control of foreign commerce solely in Congress and the difficulties of an independent commercial policy for each state, have been well summarised by Dr. E. L. Bogart in his excellent *Economic History of the United States* (p. 102 *sq.*). "Until 1789, therefore, the states undertook to regulate commerce, and by retaliatory measures to secure greater freedom (*i.e.* in foreign trade). During the years 1780 to 1788 Pennsylvania enacted fifteen tariffs, Virginia twelve, Massachusetts, New York, and Maryland, each seven; Connecticut six, and the other states a smaller number. . . . To make matters worse the states finally began to make commercial war upon each other. It had now become evident that if

trade within the empire would naturally lead to, or be accompanied by, the agreement to a common policy in the commercial relations of the various parts of the empire with foreign states.

§ 10. *Fiscal and Commercial Relations of the Empire with Foreign Countries.*

There remains, then, the difficult question: What ought to be the relations of the united British Empire to foreign states in the matter of trade? What ideas of Adam Smith are here applicable and with what results?

We cannot, of course, expect to find in Adam Smith cut-and-dried answers to our present problems. "Conditions have changed," although, as it happens, the problems of greatest moment at the present time are those which in his day were also of supreme importance, namely problems of empire. But, apart

reprisals were desirable it was impossible to carry them out so long as each state controlled its own action with regard to foreign commerce. Unified action could never be secured until Congress should be made supreme in foreign relations. Moreover, the mutual jealousies of the states were daily making some plan of central control more necessary. At the same time, American industries had been developing, and a growing desire for protection began slowly to replace the idea of retaliation." Inter-state protection was abandoned by the Constitution of 1789, but protection against foreign countries did not become the main idea of commercial policy till after the conclusion of the great Napoleonic wars. The point is that internal free trade within the states was adopted first on its own account; secondly, for the power it gave in retaliation and treaty-making; and lastly (after an interval) the commercial union was used largely for protection against foreign countries. The commercial relations of Britain and the colonies and of the colonies *inter se* are certainly much less strained and more capable of adjustment than were the relations of the thirteen states. It must be remembered also that Pitt in 1783 (no doubt under the influence of Adam Smith) tried to persuade the British Parliament to offer full freedom of trade to the new United States, possibly with the idea of again bringing about a union with the mother country.

from changes in conditions, in matters of national policy there is no appeal to authority; and what we want to find out is not what the master said, but why he said it.

If it were a question of authority merely, to be settled by the appropriate *ipse dixit*, the answer would be simple. Adam Smith certainly approved of a customs union for the whole empire; a uniform system for the whole empire.

Adam Smith deals with the proposal for an imperial customs union from the point of view of revenue; a revenue to meet the expense of defence and the expense of the general government of the empire. Land-taxes, stamps, and excise are also considered from the same standpoint. The idea is to provide an imperial revenue which shall not depend on the annual votes of the provincial assemblies but on a system of taxation for imperial purposes approved by a central authority in which the different provinces are represented.

"What is necessary for the defence and support of the whole empire and in what proportion each part ought to contribute can be judged of only by that assembly which inspects and superintends the affairs of the whole empire."[1] The object in the extension of the British system of taxation to the colonies for imperial purposes was obviously to get over the difficulty of assigning the particular contributions of the constituent states.

Adam Smith does not discuss the possibility of

[1] Book iv. chap. vii.

using the customs union for protective purposes; though he remarks incidentally that "the extension of the custom-house laws of Great Britain to Ireland and the plantations, provided it was accompanied, as in justice it ought to be, with an extension of the freedom of trade, would be in the highest degree advantageous to both." The extension of freedom of trade, however, refers to the abolition of the vexatious restraints at that time imposed on the external trade of Ireland and the colonies, including their trade with Britain.

In his treatment of taxes on consumable commodities Adam Smith lays down the general rule that customs duties ought always to be for revenue and not for monopoly, and it may be inferred that in his judgment the rule would apply also to the imperial customs proposed.

At the same time it is to be observed that although he maintained that, corresponding to every excise duty on the home product, there ought to be a corresponding customs duty on the foreign import, he never insists on the converse that corresponding to every customs duty there ought to be an excise exactly equivalent. He considers the applicability of the excise duties for imperial purposes in some detail, and incidentally gives some interesting facts on the difference between an American fermented liquor called beer, "but which, as it is made of molasses, bears very little resemblance to our beer"; but he does not suggest that for every customs duty there must be an excise in the interests of the purity of free trade.

"Absolute prohibitions and high duties," which were intended to give the home producer a monopoly, were the objects of Adam Smith's attack; and if a tax yielded a good revenue it could only give a moderate advantage and not a monopoly to the home producer.

It may be observed that it was not till long after the repeal of the Corn Laws that the maxim of countervailing excise duties was carried to the extreme of pure theory. Ricardo, for example, proposed that an import duty of 10s. per quarter should be retained on corn, not because there was an excise to that amount in the home country, but as a fair equivalent to the exceptional local taxes falling on the producers of corn. And in estimating this countervailing duty at 10s. he admits that he gave a certain benefit to the home producer. "A duty of 10s. per quarter on importation to which I wish to approach is, I am sure, rather too high as a countervailing duty for the peculiar taxes which are imposed on the corn grower over and above those which are imposed on the other classes of producers in the country; but I would rather err on the side of a liberal allowance than a scanty one."[1]

[1] Ricardo's *Works* (M'Culloch's edition, p. 493). Ricardo did not approve of general protective duties on account of general taxation. "For the same reason that protecting duties are not justifiable on account of the rise of wages generally, from whatever cause it may proceed, it is evident they are not to be defended when taxation is general and equally affects all classes of producers" (*ibid.* p. 463). Nor did he approve of the idea which was supposed to be the guiding principle in the recent revision of the United States tariff, viz. that the foreign cost should be estimated and a duty levied equal to the difference between the American and the foreign cost with a fair profit to the American producer. Ricardo argued that countervailing protection for high wages or general taxation or to secure "remuneratory" prices would mean simply general protection. Like Adam Smith, however, he did not carry the theory of free trade to a doctrinaire or punctilious extreme. The revival of

If, then, a customs union could be adopted by the British Empire with a provision for the assignment of a certain proportion of the yield for imperial purposes, especially defence, it would be absurd to object merely on the ground of the difficulty of imposing equivalent excises. Internal free trade throughout the empire, though possible without any customs union, would be promoted and strengthened thereby, and the benefits of real commercial union are too great to be cast aside on account of a literal interpretation of free trade, which is as little defensible as the literal interpretation of a scriptural text badly translated from the original.

Nor is there any reason to insist on the exact uniformity of the imperial customs so long as the main ideas are realised; namely, a sufficient revenue and a fair distribution of the burdens. The best of taxes, even in theory, is neither perfectly equitable nor perfectly free from consequences not intended. The principal difficulty to surmount is the danger of monopoly and corruption, and to guard against this danger the system adopted ought to be simple and only subject to change on important changes in conditions. The greater the complexity, so much the less suitable is the tariff for revenue, and so much more liable to sinister manipulation.

The imperial customs union might, no doubt, be used, as by other nations it is used, not merely for

the principle of continuity in economic theory warns us of the danger of arguing from particular cases to general propositions. Ricardo's approval of a 10s. import duty on corn did not make him an approver of general protection. See above, Chapter XI. § 11.

revenue but for other aims. And the possible uses for such purposes ought not to be rejected without careful consideration. A customs union for the whole British Empire would be the most powerful instrument that ever existed, if it could be used effectively, either for commercial agreements or for retaliation. The initial difficulty would be to decide on the principles which should govern the uses of so powerful a weapon; principles which would be accepted by the varied interests of the constituent states of the empire.

It must be admitted, moreover, that taxation for other than revenue purposes is beset with practical difficulties. The most ardent protectionist would hardly propose, as the model for the new British empire, the ancient Chinese type of isolation from the foreigner. And certainly there is nothing in the ideas of Adam Smith, even after making full allowance for his emphasis on the relative advantages of home over foreign trade, which would lead up to any system of "prohibitions and high duties."

The negative argument becomes overwhelming if we try to invent a complex and detailed protective system for the whole British Empire. Let any one who doubts this look at the new tariff of the United States and consider by what changes it might be adapted to the case of the British Empire.[1]

[1] The new Tariff Act (Payne) was signed by the President on 5th August 1909. It is published in the *Economist* for 21st August with the schedules in detail for the benefit of traders interested. Its general characteristics are of equal interest to the politician and economist. The dutiable list embraces fourteen schedules, and the clauses indicating various and multitudinous items are 481 in number, and extend over about twenty columns of the

But we have to take account also, not only of the negative difficulties of protection, but of the positive advantages of freedom. Dealing with "prohibitions of rival articles, or duties equivalent to prohibitions," Hamilton said: "This is another and efficacious means of encouraging national manufactures; but, in general, it is only fit to be employed when a manufacture has made such progress, and is in so many hands, as to ensure a due competition and an adequate supply on reasonable terms"; which is exactly the central idea of Adam Smith in attacking the evils of monopoly.

To attempt to confine the trade of the empire to the limits of the empire is to abandon for the empire the real advantages of foreign trade. Throughout the empire there will be surplus products; under present conditions, in England, of manufactures; in the colonies, of raw materials and food-stuffs; these

Economist in small print. The free list embraces 237 items, most of those of any importance being subject to various provisions for duties under certain conditions. The last clause in the dutiable list provides that every imported article not enumerated which is similar either in material, quality, texture, or the use to which it may be applied, to any article chargeable with duty, shall pay the same duty, etc., etc. There is also the provision of a maximum and minimum tariff, the maximum being imposed by way of retaliation on any state not granting reciprocity. Some of the duties are extremely heavy, but are not easy to quote. Ready-made clothing, made wholly or partially of wool, for example, pays in the first place a specific duty per pound on its weight, the duty being four times that on unwashed wool per pound, and in addition there is an *ad valorem* duty of 60 per cent. The differences in the duties are extremely curious. A great variety of buttons are subject to varying duties, *e.g.* metal trousers buttons (except steel) are at one rate, and steel trousers buttons at another; buttons of metal, embossed with a design, device, pattern, or lettering, pay 45 per cent *ad valorem*, but all buttons not specially provided for in the section on buttons, and all collar or cuff buttons or studs composed wholly of bone, mother-o'-pearl, or ivory, pay 50 per cent *ad valorem*. Why should a bone collar-stud pay 5 per cent more *ad valorem* than an embossed button?

surpluses must be exported to foreign parts, or else the corresponding industry will be checked. If the empire is to retaliate on the principle advocated by Adam Smith, the very object of the retaliation would be the reopening of closed foreign markets, *i.e.* the extension of foreign trade.

If we are to recall, and to insist on Adam Smith's different advantages of employing capital in different modes, we must recall not only the general statement that the home trade is more advantageous than the foreign trade, but also that trade with a near is more advantageous than trade with a remote country.

To Canada, much of the trade with the United States is more advantageous (from this point of view) than trade with the United Kingdom. Under present conditions the population of the United Kingdom is about three times as great as the (white) population of the colonies; and its wealth is in the aggregate in a far higher proportion. Under present conditions, also, the foreign trade of the United Kingdom is one of the main sources of its wealth; and any check in this trade would weaken the whole empire.

In this inquiry we are concerned mainly with the ideas and the ideals of Adam Smith which may be applied to build up a real empire, stronger in military power and stronger in all the elements of national well-being. From this standpoint the ultimate aim is of more importance than the immediate benefit. Are we to look forward to a time when the British empire shall be as little dependent as possible on the rest of the world, self-contained and self-sufficing; or

is one part of our ideal to be an extended trade that shall reach the remotest corners of the earth? The full answer to this question takes us beyond the range of economic ideas, for we must take account of the indirect political and social effects of this ever-extending commerce.

The greater the extension of the commerce of the British empire so much the greater would be its moral and political influence in promoting the general advance of civilisation.[1]

Even on narrow economic grounds, however, it is true of great empires, as of small nations, that the richer the neighbours the richer the state—and this indirect accession to opulence can only be realised by the extension of commerce.

No one has appreciated more than Adam Smith the advantages of the employment of capital in the home country and the importance of the home market; but at the same time no one has shown more clearly the real advantages of foreign trade. He condemned the policy of isolation by prohibitions; he condemned also the calculating policy of giving special favours to the nations which were supposed to be the better customers for our manufactures. By

[1] "In the case of the British possessions there are strong reasons for maintaining the present slight bond of connection. . . . It has the advantage, specially valuable at the present time, of adding to the moral influence and weight in the councils of the world of the Power which of all in existence best understands liberty, and whatever may have been its errors in the past, has attained to more of conscience and moral principle in its dealings with foreigners than any other great nation seems either to conceive as possible or recognise as desirable" (J. S. Mill, *Representative Government*, p. 133). If for the slight bond of connection there were substituted a real union so much greater would the influence become.

such a policy "the sneaking arts of underling tradesmen are erected into political maxims for the conduct of a great empire. . . . By such maxims as these, nations have been taught that their interest consisted in beggaring their neighbours. Each nation has been made to look with an invidious eye upon the prosperity of all the nations with which it trades, and to consider their gain its own loss. Commerce which ought naturally to be among nations as among individuals a bond of union and friendship has become the most fertile source of discord and animosity. The capricious ambition of kings and ministers has not during the present and the preceding centuries been more fatal to the repose of Europe than the impertinent jealousy of merchants and manufacturers."[1] The empire projected by Adam Smith was an empire with a world-wide commerce flowing in natural channels; an empire capable in case of need of insisting on the removal of obstructions from these channels and capable also of itself placing obstructions if demanded by the supreme interests of imperial defence. But the minute supervision and management of the multitudinous transactions of foreign commerce was a task not to be entrusted to "any senate whatever," and still less to the "states general" of a great empire.

With foreign trade as with currency the best system is that which is automatic in its adjustments; the worst that which requires most management. In both cases the state has duties of the highest im-

[1] Book IV. chap. iii.

portance, but the duties are best fulfilled by permanent regulations on broad principles.

In treating of the commercial relations of the states of the empire *inter se*, and of the whole empire to foreign states, attention has been mainly given to fiscal considerations. But there are many important functions of the state which would be better carried out by an imperial union than by independent action, *e.g.* the consular service, the control of the means of communication and transport, the general management of mails and telegraphs, subsidies of various kinds for defence, the regulation of emigration and immigration, the treatment of subject native races, etc.

A customs union might, by promoting closer imperial union, aid in the furtherance of these objects, just as it might aid in the adoption of internal free trade. And in spite of all the difficulties, a customs union on the lines approved by Adam Smith ought to be possible if only the idea of imperial union is once accepted.

§ 11. *The Project of an Empire.*

The outstanding merit of Adam Smith was his breadth of view; he ranged in search of facts over every country and every period; and he was not afraid to project his ideas into the future. Many of these projections have been realised; some are in process of being realised; his project of an empire is still a project. The project was outlined when, by the stress of events, the choice seemed inevitable

between disintegration and real union. It is not often, in the history of nations, that such a choice is twice offered; yet to-day it is offered to the British people under circumstances that once more convert the project of an empire into a practical proposition. In parting, let us look at the main objects free from detail; imperial defence, to which every nation or dominion or commonwealth or dependency or possession contributes its share; a system of representation by which every responsible constituent of the empire has a voice in the control of the concerns of the whole; an immense internal market for every part of the produce of all the constituents; a customs union and a common policy in commercial relations with other countries; a policy adverse to every kind of monopoly, and favourable to everything that increases the revenue and the prosperity of the great body of the people throughout the empire.[1]

[1] See above, Chapter XIV. § 8, *n.*

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